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JULY 1955

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The European Coal and Steel Community

By S. R. Dennison

ON August 10th, 1955, the European Coal and Steel Community, which was established by the Schuman Treaty of April, 1951, will complete its first three years of operation. The Treaty allowed a transitional period of five years from the introduction of the common market for coal and steel to the fulfilment of the normal conditions of that market as laid down in the Treaty. As will be shown in detail below, the primary objectives are well on the way to being fulfilled. As this article is being written, the Council of Ministers which represents the Governments of the six member States[1] is meeting to consider not only the appointment of a new President of the High Authority[2] but also the possible extension of the Community's activities to other fields.

It was made clear from the outset that, in the words of the first Report issued by the High Authority (in January, 1953), the Community " was conceived as the first step in the unification of Europe ". In the Treaty itself only a few clauses refer directly to coal and steel, and the bulk of the provisions could be applied to other industries without modification. The Community is, in fact, a new form of institution with a new type of constitutional law, and its founders visualized it as the means of achieving European integration far beyond the two industries chosen for the first experimental stages.

Coal and steel (with the associated materials of scrap and coke) are, of course, sufficiently important in themselves to make the experiment significant. The six countries produce 240 million metric tons of coal (about 10 per cent. more than the United Kingdom) and about 44 million metric tons of steel (two and one-half times the United Kingdom output). The two commodities represent between 10 and 15 per cent. of the industrial production of the member countries and about half that proportion of the gross national product; and they employ 1,400,000 workers. Even if the Community were to develop no further, it could make a notable contribution to the economic prosperity of Europe. But its real significance lies in the form of its institutions and its potentialities of development.

[1] The signatory countries are Belgium, France, German Federal Republic, Italy, Luxembourg and the Netherlands.

[2] M. Monnet, who more than anyone else was the architect of the Community, announced in November, 1954, that he would not seek re-election when his first term of office came to an end on February 10th, 1955. Since that date he has continued to act as President, but was succeeded on June 10th by M. René Mayer.

OBJECTIVES AND INSTITUTIONS

The economic objective of the Community is fundamentally simple—the creation and maintenance of a free market for these particular basic commodities within the territories of the six member States. It is believed that it is by " the establishment, the maintenance and the observance of normal conditions of competition " that " the development of employment and the improvement of the standard of living ", together with " the most rational distribution of production at the highest possible level of productivity ", can be attained.

The establishment of a free market involves not only the removal of tariff barriers and quotas, but also the elimination of all forms of price discrimination, including those in transport, and of all restrictive agreements among producers. Although the objective can be stated in these simple terms, the task is onerous and complex. Since the 1930's the six countries had protected their domestic markets by tariffs and quotas; each country had developed its own discriminatory pricing systems to assist particular groups of producers or consumers; there were innumerable transport discriminations applicable to the coal and steel industries; and, finally, these are industries in which concentrations and cartel organizations are common form.

The specific provisions of the Treaty are mostly directed towards the establishment of the conditions of a free market and prohibition of practices which impede competition. The essential feature, however, is the transfer of sovereignty from the national Governments to the institutions of the Community.

The Community itself has a fourfold organization. The High Authority is the executive body, charged with the duty of establishing and maintaining the common market. It acts without obtaining prior consent of the Governments and takes decisions which are directly binding on individual firms in the member States. It can enforce its decisions directly on the firms by means of fines, and can inspect the company books of all the enterprises involved. It finances its activities by a levy of not more than 1 per cent. on the annual turnover of the firms, and thereby imposes a supra-national tax.

The High Authority is responsible not to the member States but to the Common Assembly and the Council of Ministers. The former consists of 78 members, elected by the legislatures of the member countries. It considers an Annual Report from the High Authority, and it can remove the Authority on a vote of censure with a two-thirds majority.

The Council of Ministers is required to harmonize national policies with that of the Community. In certain matters, such as investment outside coal and steel, the High Authority cannot act without the agreement of the Council; in many others, the Authority is required to consult the Council but is not bound by its advice.

Finally, the Court of Justice is a tribunal of seven judges with power to determine whether decisions of the High Authority are valid according to the terms of the Treaty. Appeal to the Court can be made by individual enterprises as well as by member States.

The Community is, indeed, a new form of federal organization with supra-national powers involving an unprecedented recognition of the status of private individuals and corporations as subjects of rights and obligations under international law. The past three years have seen the successful application of this new form of organization to the specific problems of creating a free market in coal and steel.

THE COMMON MARKET: FIRST STAGES

The common market for coal and iron ore was opened on February 10th, 1953. That for scrap followed on March 15th and for steel on May 1st, 1953. The most obvious restrictions to be removed were tariffs and quotas, and these were abolished among the six countries on the dates specified. The High Authority had negotiated an agreement with G.A.T.T. whereby the Community was recognized as a single contracting party, so that the removal of restrictions need not be extended to other countries. The countries of the Community therefore retain their protective measures against third countries. The O.E.E.C. were notified that the Community was establishing a special customs régime within the code for liberalization of trade. The Governments of the six countries all took the necessary measures to give effect to the decision of the High Authority on the removal of barriers.

Discriminations in transport charges were also reduced as part of the initial establishment of the common market. Transport charges are of special significance in the coal and steel industries, simply because they can constitute an appreciable proportion of the final costs and of prices. For rolled steel products, for example, they represent up to 25 per cent. of the European price. They can therefore be manipulated to give effective protection to particular groups of producers, a fact which has long been recognized in the

various " basing-point " price systems in the steel industry (and in certain other industries) in the United States and elsewhere.

The six countries of the Community had in fact developed many discriminations. For example, the railway rate for Lorraine ore exported to Belgium was higher than that for ore carried within France ; the rates for Ruhr coal were higher for export to Lorraine and the Saar than for internal traffic. In the preparatory stage before the common market was opened, the High Authority examined 32 cases of discrimination internal to each country and eliminated them all. It was estimated that the rates applicable to some 45 million tons of traffic a year were modified, the total amount of reductions being equivalent to 217 million Belgian francs (£1·5 million) and the increases to 193 million Belgian francs (£1·3 million). In some cases the changes in the rates were sufficient materially to affect the competitive position of the producers in their particular markets.

This, however, was only the first step in dealing with transport charges. A second, and larger, one remained to be taken in the abolition of " split " tariffs on traffic crossing the national boundaries. These arose because a shipment which crossed a frontier was regarded as taking not one but two journeys, with the addition of imaginary terminal charges on each side of the frontier and the loss of the tapering of rates applicable to a single journey. These split tariffs were not abolished until May 1st, 1955. Their removal will involve a loss of some 20 per cent. of the receipts of the railway undertakings from international traffic, equivalent to about 2½ per cent. of total receipts, which has been made good by adjustment of other rates. An illustration of the importance of transport discriminations can be found in three steel works which, though close to each other, are separated by national frontiers. They are almost equally distant from Antwerp, the port through which they export iron and steel, yet under the old Belgian railway schedules for the export of iron and steel products (which discriminated against France and the Saar) the railway rates from the three works to Antwerp were in the proportions of 100, 125 and 172. Abolition of the specific discrimination brought these proportions to 100, 120 and 132, the gap between the highest and lowest rates being reduced by about 10/– a ton. This gap will largely disappear with the operation of the new rates from May 1st, 1955. This is clearly an important factor in the relative competitive strength of the firms in the export market.

A third type of discrimination to be modified at the outset of the common market was that of the price systems for the products themselves. Here the Community was faced with a complex problem of bewildering variety. In all six countries, government controls had been superimposed on price systems which were in any case far removed from those of a free market. In some countries, the industries were nationalized, and governments had adopted price systems designed to assist particular parts of the industry, or particular groups of consumers. Even if it had been possible to sweep away all forms of price discrimination and to allow prices to find their own level in a competitive market, it would have been the height of folly to have done so. The full establishment of the common market must mean shifts in the patterns of production and consumption, and the dislocation caused by a sudden change would certainly not have been acceptable. Moreover, there was a general shortage of coal and, to a lesser extent, of steel. The situation can be envisaged by imagining the effect of the sudden establishment of a free market for coal in the United Kingdom at the end of the war, or at the present time in place of the National Coal Board's price system.

In the field of prices, therefore, the High Authority proceeded gradually. Certain practices were modified at the outset, but the general pattern was to arrange for gradual eradication of discriminatory systems. For example, both Germany and the Netherlands had dual prices for exports and home sales; these were abolished for exports to the other countries of the Community, with the effect of reducing German export prices and slightly increasing Netherlands home prices. The Netherlands, however, also had an internal price system whereby all consumers of a particular grade of coal paid the same price for it, whatever its origin or destination (similar, indeed, to the system which is the declared policy of the National Coal Board in this country). This was clearly discriminatory, and the Netherlands Government agreed to its gradual removal; from May 31st, 1954, it was limited to household coal and finally disappeared on April 30th of this year. Again, the French industry had a subsidy for the coal used by briquetting plants on the coast, which had once used low-cost British fines but which since the war had to use dearer coal from French mines and elsewhere. The Authority agreed that the subsidy should continue, but at a falling rate. In 1953, it amounted to 2,817 francs per ton, in 1954 it was reduced to 1,933 francs per ton and it is intended that it should disappear by the end of the transition period. Even

more striking was the reduction in the French subsidies to coke from other Community countries, designed to reduce the price delivered in Lorraine to parity with that from the Nord/Pas de Calais coal-field. Before the introduction of the common market, the subsidies amounted to 683 francs per ton on 1 million metric tons per quarter; a year after the opening of the market, they were down to 51 francs per ton on 600,000 tons a quarter. It is important to recognize that the development of the common market has itself done much to reduce the need for these subsidies.

The transition to free market prices has involved two lines of action which are intended to be temporary. First, although the Authority has power to fix maximum and minimum prices, it does not expect this to be the normal procedure: its purpose is to create the conditions in which prices will be competitively determined. For the opening of the common market, however, it was thought necessary to fix maximum prices for coal and scrap, to prevent sharp increases in certain places and for certain grades. These maximum prices were kept under review, and were rescinded whenever it appeared that conditions were appropriate. Those for scrap, for instance, were abolished in March, 1954, after just over one year's operation. There has been some divergence of view on the need for maximum prices. Thus in 1954 the Netherlands Government appealed to the Court of Justice against the fixing of maximum prices for the Ruhr and Nord/Pas de Calais coal-fields, and the Court upheld the decisions of the High Authority. In deciding whether or not to fix prices for the coal year 1955–56, the High Authority consulted the Council of Ministers, which was in favour of retaining the maxima. In the event, the High Authority fixed maximum prices only for the Ruhr coal-field, and these are all that now remain. Moreover, the reason for fixing these maxima is not to temper the effects of the common market but rather to counteract the cartel organization which exists in the Ruhr. Prices for iron ore and steel have never been fixed.

Secondly, the High Authority not only has allowed certain subsidies to remain for the time being, but has itself introduced temporary measures of subsidization and equalization of returns to producers. The outstanding cases are those of the Belgian and Italian coal-fields. The Belgian coal-field has certain high-cost mines which would have been severely hit by the readjustment of prices resulting from the common market. The Italian mines, in Sulcis in Sardinia, are a legacy of autarky; they employ 11,000 workers with an output of about 1 million

metric tons a year. Productivity is very low (the output per manshift is less than one-half of that of the average for the other countries in the Community), and the mines clearly could not compete in a free market. The High Authority therefore established an " equalization " fund financed equally by a levy on the low-cost mines of Germany and the Netherlands and by the Belgian Government, which is used to subsidize some of the high-cost pits in Belgium. This again is to be for a strictly limited period, and it is significant that certain condemned pits in the Borinage are excluded, and their demise thus hastened by the operations of the free market. For Italy, the Authority has been making compensation payments, to be progressively reduced as longer-term adjustments are made.

These special measures for the transition period which were necessary for coal were not required for steel. Here the Authority was able to act more immediately to establish a free market. The method adopted was simply to require all concerns to publish their price schedules and to prohibit any deviations from them. The principle is, of course, that, if there are no restrictive agreements among producers, a free market is ensured if all consumers know the prices charged by all producers and there are no secret rebates or discriminations. There are, of course, many complexities inherent in the wide range of products and of conditions under which they are sold. There are also difficulties involved in differing incidence of taxes. The Authority has grappled with these matters with some degree of success. It might be impossible to eliminate all discriminations, but the Authority can rely on complaints from consumers as well as on its own inspections. It is reported that so far two enterprises have been fined for selling under irregular conditions, and warnings have been sent to four others. The prices are all quoted on basing points, which was the pre-Community practice. In view of the relative smallness of the distances and the multiplicity of basing points, this is not a serious drawback ; and it makes hidden discriminations more difficult. So long as the schedules are published, and filed with the Authority, any producer is free to change his prices as he wishes. A decision by the Authority to give more flexibility by allowing variations in the published prices by 2½ per cent. either way, so long as they applied equally to all sales, was declared invalid by the Court in December, 1954. All enterprises must therefore strictly observe their published schedules. The Authority does not in any way fix the prices : it merely ensures that they observe the fundamental condition of non-discrimination.

THE FIRST EFFECTS OF THE COMMON MARKET

The most immediate effect to be expected from removal of restrictions on trade is an increase in the amount of trade. This has, in fact, occurred in the six countries of the Community, as shown by the following table :—

	Millions of metric tons	
	1952	1954
HARD COAL		
1. Total production in Community ..	239	242
2. Trade between the six countries ..	15·8	22·7
3. 2 *as per cent. of* 1	*6·6*	*9·4*
CRUDE STEEL		
4. Total production in Community ..	41·8	43·8
5. Trade between the six countries ..	2·11	4·22
6. 5 *as per cent. of* 4	*5·0*	*9·6*

It is, of course, dangerous to generalize on the experience of only two years, and to neglect changes in the general conditions of trade and in the specific industries. But there is nothing to suggest that the increase in trade between the countries, and also the increase in total production, was not the result of the establishment of the common market. All six countries shared in the increases, both in exports and imports, and study of the detailed figures suggests strongly that we have here the effects of an opening of markets which were previously restricted. Certain specific movements can be clearly traced to the removal of particular restrictions, for example the effect of the abolition of transport discriminations on exports of iron ore from Lorraine and on some movements in the coal and coke trade. Although the changes are not spectacular, and so far have been largely marginal in character, the expansionist effect seems unambiguous.

There have also been changes in the trade with third countries. Exports of coal from the Community increased, chiefly to Britain. Imports fell markedly, largely because of the reduction in imports from the United States. Here, however, the dominant factor was probably change in the general conditions of the coal trade, and not the common market as such. There was little change in exports or imports of steel, though both categories showed some increase, part of which can certainly be attributed to the abolition of transport discriminations.

There have also been adjustments of prices. In coal, the initial effect was a general downward movement, which in itself is an interesting development: the establishment of a

free price system in Britain, for example, would probably have the reverse result in the first stages. It is true that the market was tending to weakness, and that the High Authority fixed maxima which differed little from the prices ruling when the common market was opened. Nevertheless, it seems clear that some of the reduction must be attributed to the removal of restrictions and discriminations. Within the fall in average prices in the Community, for coal and coke together, prices in the Netherlands and Germany have fallen, those in France and the Saar have risen, while those in Belgium have shown little change. In steel also, the general tendency was downward. After a period in which producers endeavoured to keep up earlier price levels, new schedules which became effective in February, 1954, showed general reductions, of up to 12 per cent. of earlier prices. Even with a subsequent rise in demand, prices are still below those ruling before the opening of the common market. This is regarded as particularly significant by the High Authority, in that the rising general demand from the middle of 1954 did not have any marked effect on prices in the Community, in contrast to the rest of the world. The Authority is probably correct in attributing the more gradual rise in the Community to its rules of non-discrimination and system of publication of price schedules, in other words to a competitive market.

The increase in trade and adjustments of prices which have occurred so far are only the first stages. Further changes will follow the further removal of discriminations. It has already been mentioned that " split " tariffs in transport have been abolished from May 1st, 1955 ; over the next two years it is intended to eliminate the remaining transport discriminations in the form of various terminal charges, etc. These together are at least as important as the discriminations which were abolished at the opening of the common market, and their removal will significantly affect the transport costs of a large volume of potential trade. German coal, for example, will become cheaper for Luxembourg and the Lorraine; Lorraine ore will be cheaper for Belgium ; Netherlands coke will cost less in Lorraine, and so on. The gradual removal of subsidies and equalization payments will also bring changes in the flow of trade.

So far, the changes in prices and trade have done little to affect the pattern of production : they have been of short-term significance only, and have not involved the closing down of any productive units. In the longer run, however, when a free market is fully established, some shifts in production will

be inevitable. The Borinage mines in Belgium, the Sulcis mines in Italy are but the outstanding cases; there will be many others which are now less obvious but in which at least marginal shifts in productive capacity will have to take place. For this reason, the High Authority is involved in certain matters of long-term development.

LONG-TERM DEVELOPMENT

The High Authority has certain powers under the Treaty to influence the level and direction of investment in the coal and steel industries. It can provide finance, require information about investment plans, give opinions on them and in certain conditions (if it considers that a project will require subsidies or discriminations prohibited by the Treaty) forbid them. Moreover, it can define general objectives for investment in the industries. Its intervention is limited, for it cannot lay down an investment plan in detail and then enforce it; but it can clearly exert considerable influence.

Except for two specific cases to be discussed below, the High Authority so far has been able to do no more than state general principles and collect the information on which future action must depend. The general principles are necessarily very broad. It is, for example, laid down that the enterprises of the Community must be able to compete successfully with foreign industries and with substitute products, that increasing productivity and falling costs must be the primary consideration, that changes in the structure of production will be a necessary consequence of the development of the common market, and so on. Much information has been collected, and has already thrown up certain specific problems. For example, it has been found that an almost insignificant proportion of external financing in recent years has come from long-term loans, and that short-term loans at high interest rates will involve a serious burden on the industries; the High Authority therefore regards a re-establishment of more normal methods of financing as fundamental. The main point of collecting information and studying it, however, is to try to define the objectives more precisely and thereby to have a basis for pronouncing on particular projects.

For the time being, the High Authority has confined its action to an initial period from 1954 to 1957, concentrating on projects likely to yield rapid results. Estimates made in 1953 suggested that there would be some difficulty in meeting the raw materials requirements of the steel industry, and attention was therefore directed towards iron ore, coal and (to a limited

extent) coke production, with a dual objective of increasing total output and reducing costs. The Authority's direct resources are limited to the levy of not more than 1 per cent. of the value of the output of the industries; some part of this is to be used for investment, but the main source of finance at the moment is a loan of $100 millions from the United States Export-Import Bank. The Authority invited applications from enterprises in the relevant fields for loans, and applications for $157 millions were received. So far just over $64 millions have been allocated, $23 millions to pits and mine-owned coking plants, $27 millions to pithead power stations (which can use low-grade coal which otherwise would not be competitive) and $14 millions to iron-ore mining. In no case does the Authority provide the bulk of the capital required for a project; as a rule it provides between 20 and 30 per cent. of the total, the average figure to date being 23 per cent. The coal projects include two new pits, one in the Ruhr and one in Lorraine; those for power stations include replacement of obsolete plant as well as the establishment of new units.

The planning of long-term investment is always one of the most difficult tasks, and it is not made any easier by the fact that the planning is for a free market. The Community has therefore still to face the critical tests in this field.

Shifts in production will bring with them problems of the displacement of labour, and this has also received attention. The High Authority is in any case charged with responsibilities for employment and for the living and working conditions of the labour force in the industries. As a preliminary step, it initiated studies into wages and working conditions. Differences in wages can, of course, be an important factor in competitive strength. But they appear to be less important in this case than might have been expected; excluding Italy, it seems probable that wages in the coal and steel industries differ less between the five countries than do wages in different industries within each country. The position, however, is complicated by the incidence of social security payments which, in France in particular, fall on employment in the industries rather than on general government revenue. This is one of the problems which will have to be faced in the near future. The more immediate activities have been related to assistance to workers to meet the readjustments involved in the establishment of a free market. The most notable action has been in the provision of housing. The High Authority earmarked $25 millions of the United States loan for this purpose (this is the second specific direction of investment), to help to finance the building of up

to 20,000 houses as the first stage of a total of 100,000 over the next five years. The intention is not only to improve standards of housing, but to facilitate transfer of workers. For example, high labour turnover, particularly among immigrant workers, is a feature of the Belgian coal industry. It is thought that provision of housing will encourage more permanent settlement, particularly of Italian workers. Reduction of turnover would also help to raise productivity in the Belgian mines. Transfer of workers from the high-cost coal-field of Southern France to the low-cost mines of Lorraine is also being facilitated by new housing.

The High Authority is assisting adjustment by other means, such as re-training of workers and assistance to settlement in new industries and new areas. Schemes of this kind are being developed for the workers from the Borinage coal-field in Belgium, for workers in the coal-field in Southern France, and for the Italian coal and steel industries. Another development is towards freer movement of workers among the countries of the Community. A start has been made in introducing a European passport for certain workers in the industries, and the High Authority hopes to extend this within the next two years.

CONCENTRATIONS AND CARTELS

A certain amount of interest in this country has centred on the attitude of the Community to monopoly in its various forms. There have, indeed, been suggestions that the Community is itself merely a giant cartel. The High Authority is clear that its mission includes the elimination of monopolies. The Treaty prohibits any " restrictive practices tending towards the division or the exploitation of the market ", and the two longest Articles (65 and 66) deal with agreements and concentrations in some detail. This section of the Treaty has, indeed, been described by M. Monnet as " Europe's first major anti-trust law ". There is again the significant feature of the direct exercise of power over corporations by a supra-national authority.

The benefits to be expected from a free market established by removal of all other forms of restriction and discrimination would clearly be largely nullified if monopoly were to flourish. There is therefore need for constant vigilance to ensure that the aims of the common market are not frustrated by agreements among producers. The need is intensified by the very existence of the common market itself, for a secret agreement would be one means of seeking refuge from the rigours of the new competitive market. Moreover, to the extent that agreements

are made impossible, producers might be encouraged towards complete merging; there are, indeed, signs that is already happening.

The Treaty distinguishes between concentrations (Article 66) on the one hand and agreements of the cartel type (Article 65) on the other. The High Authority has no power to break up concentrations which existed before the Treaty came into force. This, however, is not a very serious limitation, for the only part of the industries which was formerly organized on the basis of large combines was in the Ruhr, and here the Allies had already broken up the big trusts before the High Authority came into being. The largest firm in the Community today is the ARBED combine an Luxembourg, with an output of 2·5 million tons of steel a year, no larger than several British firms and smaller than most medium-sized American steel corporations.

Mergers subsequent to the Treaty have to be authorized by the High Authority unless they will involve a restriction of competition or otherwise impede the common market. This is not always a simple criterion to apply. For example, a firm which produces two million tons of steel of various grades might not have any dominant position in the market, whereas one of half that size specializing on one quality might achieve a near-monopoly position. So far the High Authority has had fourteen applications for permission to merge, and has granted seven, the others being under consideration. Only general information is published, but it is stated that none of the mergers which have been authorized give the firms a dominant position and that they all " have every appearance of being measures taken for the purpose of withstanding competition, *not* concentrations of industrial power restricting it." Even apart from the obligation on the High Authority to authorize a merger unless it is clearly restrictive, it has been influenced by the technical conditions in the steel industry, in which plants of much less than a million tons a year are usually uneconomic.

In contrast to mergers, cartels are presumed to be guilty unless they can prove themselves otherwise. The Authority can authorize them only if it is satisfied that they will lead to increased efficiency, are not more restrictive than is necessary for their immediate purpose and do not result in a limitation of competition. The Authority can enforce its decisions by fines of not more than 10 per cent. of the annual turnover of the firms involved. In July, 1953, the High Authority announced the enforcement of Article 65 of the Treaty, and thereby required all agreements among producers

to be declared. It received 71 applications for authorization of agreements. Many did not, in fact, need authorization, and others were quickly dealt with. Some agreements were authorized; these were usually selling arrangements of minor importance, such as joint selling by pits in the minor German coal-fields, or joint selling of rolled products by Belgian steel producers, amounting to 3 per cent. of the common market production. Some cartel agreements were voluntarily dissolved, others by action of the High Authority; the latter category includes the national purchasing and distributing agencies for scrap in France, Germany and Italy. A cease and desist order was issued to a large coal-selling organization in Southern Germany on the ground that it was restricting the market; in Luxembourg the Government were informed that the monopoly exercised by the national coal import office was incompatible with the Treaty and it is to be abolished, only after withdrawal of an appeal to the Court of Justice.

These many cases, though not insignificant, are still of only secondary importance. The major problems of cartel organization have yet to be solved, and the cases still outstanding are of critical importance. There is, for example, the coal cartel in the Ruhr, the so-called GEORG which controls the activities of six syndicates which are the sole sellers for 55 enterprises with an output of 80 million tons out of the Ruhr total of 98 million tons of coal a year. Of the 80 million tons sold by the group, only 8 millions go to third countries, leaving 72 millions sold in the common market. The High Authority in May, 1954, notified the syndicates that their operations were incompatible with the Treaty, as, indeed, they clearly are. Since then there have been discussions between the Authority and GEORG. The syndicates are extremely reluctant to surrender their control of the market, stressing the instability which might result for the individual mines. The High Authority, however, has pressed its case and has recently proposed a reorganization which would meet the conditions of the Treaty. Under this arrangement, six separate agencies would sell an output of 47 million tons a year, in competition with each other; 27 million tons would be left to a common agency. There would be no price agreements among the syndicates, and consumers would be free to purchase where they wished. Each of the syndicates would be authorized by the High Authority under Article 65 of the Treaty, and the Authority would thereby be responsible for ensuring that they continued to observe the conditions of the common market. The High Authority has not yet issued a final decision. It is also engaged in discussions

with the French and Belgian coal cartels (the former a government agency) over modifications of their organization and practices to bring them into line with the conditions of the Treaty.

FUTURE PROSPECTS

At the end of the first three years, the Community can show a record of considerable achievement. A free competitive market for coal and steel is well on the way to being established, and although various problems have yet to be solved there is nothing to suggest that the Community will be markedly less successful in dealing with them than it has been with those which have already been overcome. The record is, indeed, a vindication of the method of federal and supra-national organization as it has been applied to this particular limited objective. It is true that the common market has still to meet the test of a major fluctuation in general activity. The Treaty provides certain powers which can be used in an attempt to secure stability in face of generally disturbed conditions; these include, for example, the power to allocate supplies in times of shortage. There are also, of course, the powers to fix prices. Although the intentions of the Treaty are diametrically opposed to any form of restriction, and the whole policy of the High Authority is one of expansion through the fostering of competition, it is just conceivable that the Community could operate as a cartel against third parties, while still observing all the conditions of non-discrimination within its own boundaries. The organization exists, and like most organizations it could be perverted to serve ends which are far removed from the intentions of its creators. Fortunately, the risk of this is at present extremely remote, and realistic discussion must be directed towards other possibilities, of which two require notice: the implications of the expansion of the Community's activities and its extension to include other countries.

It has already been pointed out that coal and steel were regarded by the architects of the Community as merely the first step. Even if this had not been so, some extension of activity would probably have been the logical development of the establishment of the common market in coal and steel. Transport is an obvious case in which action needed to provide a competitive market for coal and steel has involved quite drastic intervention in a related field: it has been well said that the Community is not just itself a new organization for coal and steel but also a begetter of change around it. Even more directly connected with coal are the other sources of power, and it has been suggested that the logical next step is

extension of the Community to electricity and gas. Very recently the case for a European Oil Community, as part of a larger Energy Community, has been authoritatively argued.[1] It would have been surprising if similar ideas for atomic energy had not been put forward.

At the inauguration of the Schuman Plan, doubts were expressed about the feasibility of partial integration; it was thought that any attempts to establish a free market for a limited group of commodities would be paralysed by separate national policies in many fields, including taxation, labour relations, currency and so on. In fact, partial integration has been successful, but it can be suggested that it has been successful precisely because it was limited in scope. Limitation in scope has meant only a limited transfer of national sovereignty; it has also meant only marginal adjustments in national economic activities. Extension of the field of economic activity covered by the Community might well raise new problems of the extent of the transfer of sovereignty and of responsibility for fundamental national economic policies.[2]

Extension to other countries has also been among the objectives of the Community; it has continued to emphasize that membership is open to any country and has done everything possible to foster good relationships with third parties. Success in establishing the common market has important implications for other countries producing coal and steel, and extension of the Community's activities would also enhance its importance for third countries. At an early stage, various countries, including the United Kingdom and the United States, sent delegations to the High Authority, and the High Authority itself has worked unceasingly to extend this form of co-operation. In December, 1954, a further stage was reached when the United Kingdom signed an agreement with the Community, by which a standing council of association is to be established to provide for continuous consultation on matters of common interest in the coal and steel industries of the Community and the United Kingdom. The agreement has yet to be ratified by all six countries in the Community.

Britain has thus come closer to the Community than any other third country; but we are still a long way from complete participation. So far as these things can be foreseen, the British coal industry generally would have little to fear from

[1] By Dr. G. Tugendhat, *Manchester Guardian*, June 1st and 3rd, 1955.

[2] An article in this REVIEW for April, 1953, by M. Raymond Aron discussed some of the issues involved in the extension of partial integration to a wider field; events have done nothing to invalidate his conclusions.

competition from the Community. The position of the steel industry would, however, be less certain, particularly if there were to be a general recession in activity. Complete participation by Britain would mean drastic revision of price systems in both the coal and the steel industries: present policies in this country are clearly contrary to the terms of the Treaty. There would also be certain difficulties over Imperial Preference, although the extent of these appears to be often exaggerated. These matters are not, however, of critical importance. It might, indeed, be argued that it would be a highly desirable thing for the coal and steel industries in this country to have to establish and face the conditions of a competitive market. The real problems lie elsewhere and are political in nature.

There is the problem of a transfer of sovereignty, though there seems no inherent reason why this should be greater for this country, which after all has a good record in the acceptance of jurisdiction by international bodies, than for any other. There are also doubts whether the method of the Community is in fact the right path towards the integration of Europe. Although it has unique features, the Community is but one of several organizations which are pursuing similar objectives, and the view in this country has generally been that it is better to seek solutions to the problems of Europe by development along a broad front rather than to commit ourselves to the success of a single venture, however promising it may be. Other organizations, such as O.E.E.C., have made their contributions and can continue to do so, and there is much to be said for being good Europeans wherever and whenever the opportunity offers. It may be that the activities of the Community will grow to an extent such that it is no longer an alternative among several organizations but the one major force leading to European co-operation. In his Reith lectures last year, Sir Oliver Franks suggested that the form of organization adopted in the Schuman Treaty would indeed prove to be the line of solution, and that "August 10th, 1952, was likely to be regarded by future historians as the most important date in the post-war decade of Western Europe". It is not for an economist to make a final pronouncement on these larger issues.

S. R. DENNISON.

Cambridge.
June, 1955.

The National Debt and Monetary Policy

By Professor E. Victor Morgan

THERE has been much discussion during recent months of a return towards traditional methods and techniques in monetary policy. These techniques were developed before the first world war when the gold standard was in full operation, when Great Britain was a creditor of the rest of the world both on short and long term, and when London enjoyed an unchallenged supremacy among international financial centres. This was also a time when the public debt played only a small part in the market for long-term capital, and an insignificant part in the market for short-term credit. The significance of London's altered international situation has been very fully discussed, but the rôle of the national debt has received comparatively little attention. The growth of the debt has been accompanied by changes in financial institutions and in the type of asset held by those who are the ultimate owners of property rights. Two of these changes, the increase in the volume of liquid assets and the growth of financial intermediaries, are of special significance for the problem of monetary management.

The growth of the debt in itself marks a great change in the economic and social significance of property. Prior to 1914, 95 per cent. of all property rights represented the ownership of physical capital. Of course, this ownership was not always direct; the man of property might hold shares in a company which owned physical assets, or deposit his money in a bank which made loans to business for the purchase of physical assets. The crucial point, however, was that the property rights were ultimately backed by the existence of real capital, and the income of the property owner was ultimately derived from the productivity of that capital. This situation arose, of course, because the savings which gave rise to property rights either were used by the savers themselves for capital formation or were lent to others who used them for that purpose.

The saving which was embodied in the national debt was used not for the creation of capital but for the waging of war. There is very little in the way of real capital behind the debt (apart from the nationalization issues) and the income of its holders is derived from a claim on the proceeds of general taxation. This has long been recognized in the classification

" transfer payments " in which national debt interest is placed by the social accountants. We thus have two forms of property, similar from the point of view of the owners in that both are the result of saving, but radically different from every other angle. It is in some ways a disturbing thing that the property rights which do not correspond to the existence of any real capital should now amount to half the total.

THE FINANCIAL INTERMEDIARY

The distinguishing characteristic of the financial intermediary is that the firm does not hold physical capital to any significant extent. Its liabilities consist of the claims of its shareholders and/or depositors on its resources, and its assets consist of similar claims on the Government, on other firms or on individuals. A number of otherwise very different institutions have this characteristic in common. The most important are commercial banks, discount houses, investment trusts, building societies, insurance companies, pension funds, collecting societies and friendly societies. The Government is in a similar line of business through the savings banks, though it is in a rather curious position in that the assets which it holds are almost entirely claims upon itself.

There have been financial intermediaries at least since ancient Babylon, but the range of their activities and their importance in the economy have grown enormously during the past forty years. It is difficult to measure their activities statistically. For some of them (e.g. pension funds) no complete figures are published, and only a very rough guess can be made. For others (e.g. the savings banks) different institutions make up their accounts at different dates, so that it is not possible to get complete figures for all at the same time. For these and other reasons the figures in the table overleaf are expressed only in round numbers, and should be taken as doing no more than indicate the broad orders of magnitude involved.

This table contains a certain amount of double counting : e.g. loans by the commercial banks to the discount market and balances of insurance companies and other institutions with the banks. On the other hand, it excludes a number of minor financial intermediaries, such as banks other than the London clearing banks and the Scottish banks, and hire purchase finance companies. We can say, therefore, that between 40 and 50 per cent. of all property rights are exercised through financial intermediaries.

The joint stock company in industry and trade marked one stage in the transformation of property ownership. Instead of owning physical assets directly, one could own the liabilities of an institution which owned physical assets. The growth of the public debt brought in claims against the Government as an alternative form of property right. The financial intermediary carries the process a stage further. Instead of owning government securities one may own claims against an institution which owns government securities ; instead of owning real capital or shares in a company which owns real capital, one may own claims against an institution which owns claims against another institution which owns real capital.

Financial intermediaries fall into two broad groups which we may call " insurance type " and " banking type." " Insurance type " business is done by pension funds, collecting societies and friendly societies, as well as by the insurance companies themselves. The claims against these institutions have the common feature that they are payable only in certain contingencies : death, the attainment of a certain age, the loss of one's property, etc. In any other circumstances than those insured against, the value of the premiums paid can be recovered, if at all, only at a considerably reduced surrender value. Thus, while insurance policies form part of the assets of those who hold them, they are highly illiquid assets. The common characteristic of the various " banking type " institutions is that their liabilities are payable at a fixed money value either on demand or at very short notice. The growth of this type of business, therefore, provides the public with assets more liquid than those which the intermediary itself holds.

Assets of Financial Intermediaries. Nearest available accounting date to March, 1953

	£m.
Commercial banks	6,800
Discount houses	1,200
Investment trusts	700
Building societies	1,640
Insurance companies	3,810
Pension funds	1,250
Collecting societies	205
Friendly societies	215
Savings banks	2,750
Total ..	18,570

THE GROWTH OF LIQUID ASSETS

This property of liquidity also applies to some assets not created by financial intermediaries: e.g. legal tender money. An attempt has been made to measure the growth of all these liquid assets in the hands of the public. "The public" for this purpose has been taken as all British residents, companies and other corporate bodies, except the Government, government agencies and financial intermediaries. The assets classed as liquid are legal tender money, bank deposits, deposits in the Post Office and Trustee savings banks, National savings certificates and Defence bonds, and shares and deposits in building societies and in co-operative societies. The last named come in because they are highly liquid, even though in other respects they are more analogous to the shares of an ordinary company. The discount market has been omitted because its liabilities are not, in general, the assets of the public, as here defined, but of domestic and foreign banks. Insofar as deposits with discount houses are held by the public, this fact will help to compensate for the inclusion in our estimate of some items which ought not to be there but which cannot be kept out, such as bank deposits held by foreigners.

The figures for notes and coin are exclusive of those held by the banking system, though the figure for 1914 is very tentative. It seemed better to treat liquidity as a net rather than a gross concept, and to exclude so far as possible the "quick" liabilities of the public. The figure for deposits is, therefore, that of total deposits less advances and discounts of bills other than Treasury bills. The change in monetary policy of 1932 had an important influence on the supply of liquid assets and made necessary an intermediate estimate between 1925 and 1953. The year 1934 was chosen, largely because it is one of the years for which Campion made a detailed estimate of the value of private property. The results of this estimate are shown in the table on page 23.

A comparison of these figures with the estimates of national income compiled by Mr. A. R. Prest[1] shows that liquid assets were equal to half a year's national income in 1914, about 55 per cent. in 1925, and about 75 per cent. in 1934. There is no strictly comparable figure for 1953, but liquid assets were then equal to 94 per cent. of gross national product as estimated in the national income white paper. Had figures on the same basis as those of Mr. Prest been available, they would probably have

[1] *Economic Journal*, March, 1948.

shown that liquid assets exceeded the value of a year's national income. Another way of looking at the matter is to express the total of liquid assets as a proportion of the total value of private property. When this is done it appears that liquid assets formed about 9 per cent. of all property in 1914, 10 per cent. in 1925, 13 per cent. in 1934, and between 30 and 35 per cent. in 1953. The first world war brought little change in the importance of liquid assets in relation either to property or income, but the inauguration of cheap money brought about a significant increase, which was carried a great deal further during the second world war and the early post-war years. The influence of the war appears much less strongly in the relationship between liquid assets and income than in that between liquid assets and property. This is, of course, because inflation raised the money value of the national income by considerably more than the value of property.

There are several reasons for this increase in net liquidity. The most obvious is the change in the volume of currency and bank deposits. This has grown at a much faster rate than the total value of property. Up to 1947 it was also increasing faster than income, but since 1947 income has been increasing more rapidly than currency and bank deposits, and the relationship between them is now back to roughly what it was before the war. The net liquid assets position has also been affected by the change in the composition of commercial bank assets. In 1914, government securities of all kinds were only about 15 per cent. of the banks' total assets, whereas in 1953 they were over 50 per cent. The granting of an overdraft or the discounting of a commercial bill gives rise to an increase in deposits, but it also causes an equal increase in the quick liabilities of customers. By our present definition, these transactions make no difference to the net total of net liquid assets. The purchase of Treasury bills or other government securities creates an increase in deposits which is not offset by any increase in the quick liabilities of the public. The change in the composition of bank assets has thus played a large part in the growth of net liquidity.

It has been official policy to provide liquid assets for the so-called " small " saver, and to entice him into them with every possible blandishment. This combined appeal to patriotism and self-interest has created a tenfold increase in savings bank deposits, and some £3,000 millions of savings certificates and Defence bonds. Most of this growth in " national savings "

took place during and immediately after the two world wars, when incomes were high and consumption artificially restricted. There is ample evidence, however, that in normal times and without official encouragement, many investors are attracted to assets which are liquid and at the same time carry a modest rate of interest. Although deposits in the Post Office savings bank have declined somewhat since 1947, the Trustee savings banks are still growing fast, and the building societies have more than doubled their liabilities since the war.

There is some reason to believe that this liking for liquid assets is linked with the redistribution of property which is gradually taking place under the influence of income tax and death duties. According to Campion's figures, there was a steady decline, between 1913 and 1936, in the proportion of property held in very large estates, and the recent calculations of Miss K. M. Langley suggest that the trend is continuing.[1]

It would be much easier to see the significance of these changes if more were known about the general structure of property ownership. In particular we should like to know who holds the liquid assets, and what types of asset are held by the financial intermediaries. We have lumped together individuals and business firms as " the public," but liquid assets have a different significance for the two groups, and it would be far more satisfactory if we could show the holdings of each group separately.

Estimates of personal holdings divided into broad asset groups can be compiled from the estate duty returns, but there are many snags in using them and, in any case, they refer only

The Growth of Net Liquid Assets in the Hands of the Public

	1914	1925	1934	1953
	£m.	£m.	£m.	£m.
Legal tender money	150	380	360	1,470
Deposits less discounts and advances ..	610	800	1,020	4,640
Savings bank deposits	256	397	498	2,752
Savings certificates and Defence bonds ..	—	370	384	3,119
Building societies	62	137	477	1,558
Co-operative societies	46	107	160	337
	1,124	2,191	2,899	13,876

[1] *Bulletin of the Oxford Institute of Statistics*, February, 1953, January, 1954.

to estates of over £2,000. We know that shares and deposits in building and co-operative societies and " national savings " are mainly personal, though a recent enquiry has suggested that non-personal holdings may be more important than one would expect.[1] These assets are designed for the " small " saver, but it is possible to have holdings in the names of several members of a family, to hold several types of " small savings " at once, and to combine these holdings with other assets of any amount. It is probable, therefore, that some so-called " small savings " are in the hands of people of considerable wealth, though it is impossible to say how much. Of personal holdings of bank deposits, we know only what the British Bankers' Association told the Royal Commission on Taxation in 1951: that rather less than 40 per cent. of " deposits less advances " were held by persons. Of personal holdings of legal tender currency, we know nothing at all. In view of this paucity of information, comment on the changes which we have described is bound to be very tentative.

LIQUID ASSETS AND THE SUPPLY OF CAPITAL

The growth of liquid assets may have a significant influence on the willingness of a community to save. It is possible that a person whose existing property is in a highly liquid form may be content with rather less property, and so do rather less saving than he otherwise would. A more likely contingency is that the holder of liquid assets may be tempted to dis-save. If he is confronted with some sudden misfortune, or if he is lured into the purchase of durable goods, he may meet the additional expenditure by realizing some of his assets instead of by reducing current expenditure in some other direction. It seems quite likely, therefore, that the existence of a large stock of liquid assets tends to reduce the propensity to save of a community.

The growth of financial intermediaries is not likely in itself to have affected the total amount of saving, but it has had a profound effect on the way in which savings are made available to those who need them for capital formation. A very large proportion of new saving, other than undistributed profits and budget surpluses, is done through one or other of the financial intermediaries. Savings which take the form of increased holdings of notes and coin or increases in " national savings "

[1] H. F. Lydall, " National Survey of Personal Incomes and Savings," *Bulletin of the Oxford Institute of Statistics*, November and December, 1952, and subsequent issues.

are, of course, placed directly at the disposal of the Government. Those which take the form of increased bank deposits (which they can only do if the Government provides the necessary cash base) are either placed at the disposal of the Government or lent to business for the provision of circulating capital. Increases in shares and deposits with the co-operative societies are used directly in the business, while savings made through insurance companies, pension funds and friendly societies are divided, in varying proportions, between mortgage loans, government securities and industrial shares. The building societies, whose funds have been growing very rapidly, have undergone an important change in their position in the capital market. During the private building boom of the nineteen-thirties, their funds went directly into new bricks and mortar ; now their loans are mainly for the purchase of existing houses, so that the ultimate effect on the capital market depends on what the sellers of these houses do with their money.

Apart from undistributed profits, there are thus three possible sources of supply of funds for the capital market :—

(*a*) the purchase of shares out of new personal savings,
(*b*) personal purchases out of the proceeds of sales either of houses or gilt-edged, and
(*c*) purchases by insurance companies, pension funds and investment trusts.

The market has to rely heavily on the institutional investor, and some people fear that a dearth of risk capital may result. The rich who hold the largest proportion of risk capital are being taxed out of the market, runs the argument. The medium and small savers are either holding liquid assets or saving through the " insurance type " institutions, and these institutions are prevented by considerations of safety and by accounting conventions from putting more than a small proportion of their funds into industrial shares.

It is difficult to reconcile this argument with the recent boom in equities, and I believe it overstates the case. So long as personal saving continues at its present level, there is some room for additions to personal holdings of industrial securities from this source. There is also considerable room for switching from houses and gilt-edged, if property owners so desire ; in 1953, persons with estates of over £2,000 probably held at least £4,000 millions of government securities. There are some signs that medium and small investors are taking an increasing interest in the industrial market, and a number of pension funds,

insurance companies and charitable funds are increasing the proportion of industrial shares in their portfolios. There does not seem to be any real danger of a dearth of industrial capital, though the growing importance of the institutional buyer may accentuate the advantage enjoyed by the large firm in the capital market.

The growth of liquid assets in the hands of the public has created a demand for liquid assets from banks and similar institutions. Before 1914, the liquid asset normally held by institutions was the commercial bill. With the virtual disappearance of this asset, the national debt has had to fill the void, and also to provide the backing for the enormous growth of liquid assets in the hands of the public, which has already been described. The insurance type of institution is in a different position. With its liabilities calculable and, in the main, distant, it can afford to keep only a small proportion of liquid assets and to look mainly to stability of income. The savings banks are in yet a third category, for their funds are invested by the National Debt Commissioners and guaranteed by the Government. In return for this guarantee the Government feels free to use the funds with less regard for liquidity than would be necessary in a private banking institution, and a considerable portion of them are invested in special non-market issues.

THE NATIONAL DEBT AND PRIVATE PROPERTY

At this point it may be well to illustrate the growth of the debt with a few figures. In March, 1914, the nominal value of the debt was just under £650 millions, of which nearly £540 millions was in 2½ per cent. Consols and a mere £13 millions in Treasury bills. Consols were well below par and the market value of the debt was only about £500 millions. Government Departments, including the savings banks, held about £200 millions (nominal). The commercial banks, including Scottish and Irish banks, held £190 millions at their own balance-sheet valuation. Thus there could not have been more than £250 millions nominal, or less than £200 millions at the current market prices, of government securities in the hands of all other persons and institutions. Against this, the total value of all private property was about £12,500 millions[1] and the securities

[1] The figures for the value of property are based on H. Campion, *Public and Private Property in Great Britain*. Campion's figures have been slightly modified to take account of differences in date.

quoted on the London Stock Exchange had a nominal value of £11,000 millions, though their market value was considerably less.

The first world war raised the nominal value of the debt by almost exactly ten times and in March, 1925, it amounted to £6,525 millions. The total value of private property had risen, largely because of the rise in prices, to about £22,000 millions, but the national debt had grown from about 5 per cent. to about 25 per cent. of total private property. There was about £740 millions of floating debt and a further £1,020 millions maturing within five years. At the other end of the scale, nearly £3,500 millions had redemption dates more than twenty years ahead. Departmental holdings (including the Currency Notes Redemption Account and the savings banks) had risen to about £1,000 millions and those of the Bank of England, the commercial banks and the discount market to about £750 millions. However, government securities had become much more important among the assets both of individuals and institutions. So far as can be estimated from the estate duty returns, personal holdings of government securities amounted to about £2,000 millions, besides some £370 millions of savings certificates and nearly £400 millions of savings bank deposits.

The advent of cheap money after 1932 brought important changes in the structure of the debt and in its management, some of which will be discussed later, but there was comparatively little change in the total volume of the debt and in its relationship to other forms of property.

The second world war raised the debt by nearly fourfold, to a peak of over £25,000 millions in 1947. By March, 1953, this had been reduced to £24,250 millions. Of this, £14,000 millions was in securities quoted on the London Stock Exchange. There is no estimate of the total value of property since the war which is comparable with those for earlier times, but at a rough guess we could put the value of property in March, 1953, at between £40,000 and £45,000 millions. The national debt thus formed between 50 and 60 per cent. of the total value of private property. A considerable part of the debt was not held, even indirectly, by British citizens. The holdings of government Departments had risen to about £4,000 millions; the nationalized Bank of England held nearly £2,000 millions, and an unknown amount—probably several thousand millions—was in the hands of foreign persons or institutions. On the other hand, these figures refer only to the national debt in its strictest

sense, and do not include some £2,800 millions of nationalization issues carrying a government guarantee, while the holdings of the National Debt Commissioners on behalf of the savings banks represent private property at one remove. Government and government guaranteed securities, held either directly by British citizens or by institutions acting on their behalf, thus form roughly half of all private property.

THE STRUCTURE OF THE DEBT AND THE PATTERN OF INTEREST RATES

The way in which the national debt has been tailored to fit the various needs of its holders during the past twenty-five years is shown in Chart I. The floating debt, which had been painfully reduced during the nineteen-twenties, was under 8 per cent. of the total[1] in 1931/32, rose to 27 per cent. (including Treasury deposit receipts) in 1945/46, and has been fairly stable at about 18 per cent. during the past three years. The "under 3 year" and "3 to 10 year" groups, in which the banking system is mainly interested, formed about 9 per cent. of the total in 1929, shrank to less than 6 per cent. in 1933, and have recently been running at about 19 per cent. At the other end of the scale, undated stocks and dated stocks with more than twenty years to run formed 28 per cent. of the debt in 1929, rose to no less than 55 per cent. in the middle 1930's, and have since fallen to about 20 per cent. The non-market issues, which have grown from about 7 per cent. to about 20 per cent. of the total are mainly savings certificates, Defence bonds and special issues to the National Debt Commissioners for the savings banks.

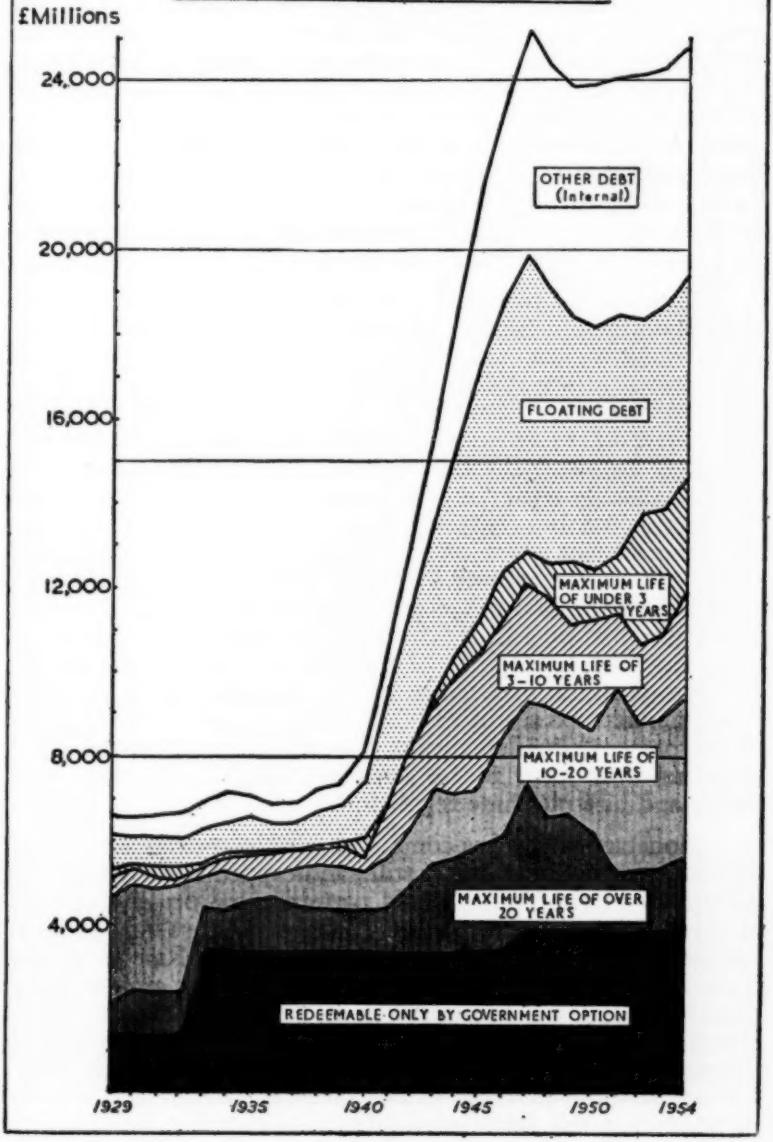
These changes in the structure of the debt have been associated with important changes in the pattern of interest rates. Chart II on page 31 shows yield curves for December, 1929, and December, 1951. The gross redemption yields of the various stocks have been plotted against latest redemption dates, and a smooth curve fitted. There are many reasons why some stocks do not lie exactly on the curves. Stocks with a high coupon usually have a slightly higher yield owing to the influence of taxation, while those with a long option also tend to have a higher yield.

The great increase in the supply of short-term assets has

[1] Including external debt.

Chart I

THE STRUCTURE OF THE DEBT



been accompanied by a spectacular fall in their yield. This apparent paradox can be explained partly by the increased demand for liquidity and partly by the increase in the cash base of the banking system. The long-term rate, however, has proved very resistant to any attempts to bring it down below about 3¼ per cent. Although the Departments have occasionally supported the market for long-term securities, this has not been done on a sufficient scale or with sufficient regularity to remove the risk of substantial fluctuations. So long as this risk remains, holders have to be compensated for bearing it and they are likely to be very sensitive to a reduction of yields below what they regard as a historically normal level.

There can be no doubt that a very high degree of liquidity is a handicap to a flexible monetary policy. The war and the period of ultra-cheap money which followed it left both business and persons in a very liquid position. As has been said, however, bank deposits have since 1947 risen less rapidly than incomes, and are now back to roughly their pre-war proportion. Advances are relatively less important, so that the net liquidity of the business sector is still somewhat greater than before the war, in relation to the volume of transactions; but the difference is not great and it appears still to be declining. Persons, however, are still in a very much more liquid position than before the war. It is often said that personal spending is not likely to be a causal factor in economic fluctuations, so that a high degree of personal liquidity does not greatly matter. In view of recent experience in this country and in America this generalization seems a little too glib. However, the realities of the present situation dictate that any control over personal spending will have to be exercised mainly through fiscal policy and hire purchase regulation.

Monetary policy has come back into its own as a regulator of business spending but it is still handicapped by an anomalous pattern of interest rates. This pattern grew up in the early nineteen-thirties, survived the changes of 1951–52, and has persisted at least until the recent rise in Bank Rate to 4½ per cent. It originated in the idea of cheap money as a cure for depression and was continued as an aid to war finance. The cheap money policy was only partially successful, because of its failure to bring down the long-term rate of interest sufficiently. Keynes saw the problem in the nineteen-thirties and recommended that the Bank of England should deal not only in

Treasury bills but in longer-dated government securities at fixed prices. Just this technique was operated by the Federal Reserve System during and immediately after the war. Taken to its logical conclusion, this policy could reduce rates to any desired level, but it makes all assets liquid assets and makes it almost impossible to use monetary policy as a curb on inflation.

For the present and the foreseeable future, the need is for a curb on inflation, and monetary policy will have to work mainly through business liquidity and the short-term rates of interest. The long-term rate is not likely to be much of a weapon, for housing and nationalized industry are supremely indifferent to it, and fixed capital investment in private industry is the thing which we can least afford to curtail. On the other hand, it would be unwise to ignore the facts that the economy may eventually become more sensitive to long-term rates (e.g. through the revival of private building) and that there may come a time when it is desired to reduce long-term rates as an antidote to depression. Present long-term rates are high compared with their historical average ; a further rise would do little good now

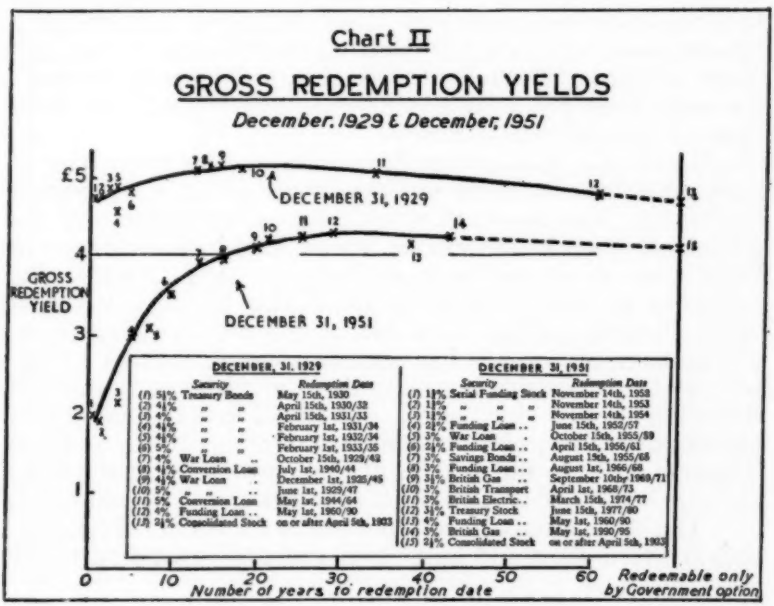


Chart II
GROSS REDEMPTION YIELDS
December, 1929 & December, 1951
£5
4
3
2
1
GROSS REDEMPTION YIELD
DECEMBER 31, 1929
DECEMBER 31, 1951
0
10
20
30
40
50
60
Number of years to redemption date
Redeemable only by Government option
DECEMBER, 31, 1929
Security
Redemption Date
(1) 5½% Treasury Bonds May 15th, 1930
(2) 4½% " " April 15th, 1930/32
(3) 4% " " April 15th, 1931/33
(4) 4½% " " February 1st, 1931/34
(5) 4½% " " February 1st, 1932/34
(6) 5% " " February 1st, 1933/35
(7) 4% War Loan .. October 15th, 1929/42
(8) 4½% Conversion Loan July 1st, 1940/44
(9) 4½% War Loan . December 1st, 1925/45
(10) 5% " " June 1st, 1929/47
(11) 5% Conversion Loan May 1st, 1944/64
(12) 4% Funding Loan .. May 1st, 1960/90
(13) 2½% Consolidated Stock on or after April 5th, 1923
DECEMBER 31, 1951
Security
Redemption Date
(1) 1¾% Serial Funding Stock November 14th, 1953
(2) 1¾% " " " November 14th, 1953
(3) 1¾% " " " November 14th, 1954
(4) 2½% Funding Loan .. June 15th, 1952/57
(5) 3% War Loan . October 15th, 1955/59
(6) 2½% Funding Loan .. April 15th, 1956/61
(7) 3% Savings Bonds .. August 15th, 1955/65
(8) 3% Funding Loan .. August 1st, 1966/68
(9) 3½% British Gas .. September 10thr 1969/71
(10) 3% British Transport April 1st, 1968/73
(11) 3% British Electric.. March 15th, 1974/77
(12) 3½% Treasury Stock June 15th, 1977/80
(13) 4% Funding Loan .. May 1st, 1960/90
(14) 3% British Gas .. May 1st, 1990/95
(15) 2½% Consolidated Stock on or after April 5th, 1923

and would leave a very awkward legacy if and when a thorough-going cheap money policy is desired.

The immediate need is for greater flexibility of short-term rates in relation to long-term rates, and this is a characteristic of the "traditional" pattern which existed before 1931. The following figures show the relationship between the average yield on Consols and that on 3 months bank bills.

Period	*Consols Yield*	*Bill rate*
	%	%
1849–1909	3·0	3·2
1910–4	3·3	3·4
1915–8	4·3	4·3
1919–21	5·1	5·1
1922–31	4·5	3·8

Until 1921 the average of the two rates was almost identical. The large funding operations of the nineteen-twenties opened up a slight gap, but only a fraction of that which has persisted since 1932. The range of fluctuations, however, was much wider for short-term rates, so that it was normal for bill rate to rise well above Consols rate in times of dear money and to fall well below it when credit was abundant. From 1932 to 1954, bill rates were always below the Consols yield, but the extreme range of fluctuations (up to February, 1955) has been about the same, from ½ to a little over 2½ per cent. for bills and from 2½ to 4½ per cent. for Consols.

There has been a significant change in the pattern of rates since Bank Rate rose to 4½ per cent., and this is shown in Chart III[1]. This shows three yield curves: at the peak of the gilt-edged boom in November, 1954; just before the rise in Bank Rate to 3½ per cent. in January, 1955; and at the beginning of June, 1955, when the market had adjusted itself to the 4½ per cent. Rate. It will be seen that the yield on short- and medium-term stocks has risen far more than that on long-term and irredeemable issues, so that there has been a marked flattening of the yield curve. If the Treasury bill rate is expressed as a rate of interest instead of discount, the yield on Treasury bills in the middle of June was only about three shillings below that on Consols at the other end of the spectrum.

This is a spectacular return towards the historical relationship between short and long rates, and one is tempted to ask

[1] See also chart on page 47.

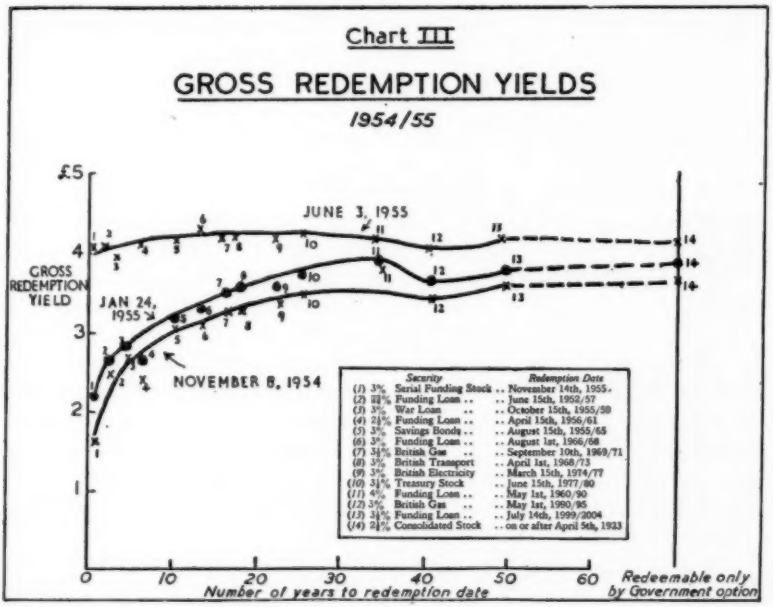


Chart III
GROSS REDEMPTION YIELDS
1954/55
£5
4
3
2
1
GROSS REDEMPTION YIELD
JUNE 3, 1955
JAN 24, 1955
NOVEMBER 8, 1954
Security
Redemption Date
(1) 3% Serial Funding Stock .. November 14th, 1955.
(2) 2½% Funding Loan .. .. June 15th, 1952/57
(3) 3% War Loan .. .. October 15th, 1955/59
(4) 2½% Funding Loan .. .. April 15th, 1956/61
(5) 3% Savings Bonds .. .. August 15th, 1955/65
(6) 3% Funding Loan .. .. August 1st, 1966/68
(7) 3½% British Gas .. .. September 10th, 1969/71
(8) 3% British Transport .. April 1st, 1968/73
(9) 3% British Electricity .. March 15th, 1974/77
(10) 3½% Treasury Stock .. June 15th, 1977/80
(11) 4% Funding Loan .. .. May 1st, 1960/90
(12) 3% British Gas .. .. May 1st, 1990/95
(13) 3½% Funding Loan .. .. July 14th, 1999/2004
(14) 2½% Consolidated Stock .. on or after April 5th, 1923
0
10
20
30
40
50
60
Number of years to redemption date
Redeemable only by Government option

how much further the movement may go. If we are to rely largely on monetary policy to keep the economy on the narrow path of full employment without inflation, frequent changes in Bank Rate will be needed, and there will probably be times when it will rise above its present level. Historical precedent would suggest that, at such times, short-term rates should rise above long-term ones and that they should fall back below long-term rates again as monetary discipline is relaxed. If the recent change turns out to be the beginning of a return to greater flexibility, this will be in keeping with what has happened in other sections of the capital market, and it will be another big step towards restoring monetary policy to its full stature in the economy.

E. VICTOR MORGAN.

University College of Swansea.
June, 1955.

Australia as a Factor in the Sterling Area

By D. H. Merry *

RECURRENT balance of payments difficulties in the post-war period have focused attention on the significance of Australian overseas trade as a factor in sterling area finances. Australia is an exporter of rural products and the value of exports fluctuates from year to year, due not only to movements in world commodity prices but also to seasonal variations which affect the volume of production. The supply of primary products is slow to respond to changes in demand because of the seasonal nature of production and as a result price changes are all the more violent, while the level of imports tends to fluctuate broadly according to variations in the level of export receipts.

The tendency for a year of high export returns to be followed immediately by a year of heavy imports, which has been noticeable over a long period of Australia's overseas trade statistics, has been accentuated in the 1950's. In the financial year 1950–51 Australia's export proceeds were inflated by a record wool income and in the following fiscal year restrictions were imposed to stem the flow of imports, which had assumed embarrassing proportions. Overseas currency resources, which had accumulated during the war and early post-war export seasons, reaching the extraordinarily high figure of £A843 millions at the end of June, 1951, drained rapidly away, falling to little more than £A360 millions at the end of June, 1952. The decision was taken to impose some limitation upon imports in order to husband overseas resources and to avoid excessive dislocation which would be bound to follow a continued heavy adverse balance of payments. This decline in Australia's overseas currency resources imposed a strain on the balance of payments of the sterling area as a whole, and the resulting import restrictions had the effect of limiting the area in which goods could be sold by the United Kingdom.

The import restrictions imposed in 1952 were accompanied by credit control and fiscal measures aimed broadly at cutting down the level of internal activity which had caused significant

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inflationary pressure to develop. These measures sharply checked internal activity, with a drop in the level of trade and a rise in unemployment that caused some concern within Australia. The controls met with a marked degree of success, as shown by the relative stability of prices and lack of inflationary pressure after the middle of 1953, the retail price index rising only from 258·6 to 263·1 between June, 1953, and December, 1954. But in spite of price stability there has been a recurrence of difficulty with the balance of payments. Import restrictions were progressively relaxed over a period, and were no longer seriously restrictive by April, 1954; but overseas currency resources, which had built up satisfactorily after the end of 1952 (rising to £A540 millions in May, 1954) declined steadily in the later months of 1954 and early months of 1955. This downward trend was met by a tightening of import restrictions in the last quarter of 1954, followed by a reimposition of more definite controls in April this year.

These separate decisions to impose import restrictions and the effect they have had on Australia's import trade and on her suppliers in overseas countries have caused adverse comment and criticism. Criticism has been levelled mainly on two counts:

(i) The rapid expansion of manufacturing industry;
(ii) Failure to impose adequate measures of credit control.

EXPANSION OF MANUFACTURING INDUSTRY

The industrialization of Australia during and immediately after the last war took place at a time when much industry was relatively protected against imports because of the lack of supply of goods from overseas sources. To meet the shortage of goods in Australia, manufacturing industry expanded production for the home market. It seems reasonable to presume that in such circumstances a number of industries probably started up which, under normal trading conditions with a free flow of goods from abroad, would not have had sufficient incentive or sufficient opportunity to get into full operation.

It might be argued that Australia has dispersed her resources over too wide a field too rapidly, and has undermined some of her strength in doing so, with consequent inefficiency in industry leading to high costs and an unbalanced economy, reflected in turn in instability in the balance of payments. It is worth bearing in mind, however, that, both in population and in size, Australia ranks ahead of the

Scandinavian countries, while taking population alone she nearly equals Holland. These countries have more highly diversified industry than Australia, and are closer to ready sources of manufactures in the highly industrialized countries, yet one hears little criticism of their having undertaken a programme of uneconomic diversification which cannot be supported by their existing industrial structures.

Perhaps the growth of Australia's manufacturing industry has introduced some complication into the general structure of her overseas trade. A number of important questions arise in this context, all of which have a bearing upon the balance of payments. If Australia manufactures more of her own requirements, will she import less and consequently find that demand for her products abroad will inevitably shrink and that she will be forced to export less? If Australia's manufacturing industries continue to expand, and the numbers of the work force engaged in those industries increase correspondingly, will home consumption of the main export products rise to a point at which there will be a much reduced margin for export, and consequently a lower level of funds to pay for imports?

These are questions which must cause concern in a young and developing country with a widely based structure of manufacturing industry that has grown rapidly in recent years. In considering the first of these questions, there can be little doubt that, by any test, a vital part of the structure of Australia's manufacturing industry must be regarded as essential to the economy. Obviously, the basic industries fall within this category. In the same category must be placed a broad cross-section of industries which came into being or grew rapidly to maturity under the stimulus of war. These industries were developed to increase Australia's capacity to meet her own requirements of many types of equipment, munitions and supplies, at a time when overseas sources were unable to meet urgent Australian demands; and they continue to be significant under existing conditions of international uncertainty.

Bearing these factors in mind, one must set aside some of the criticisms that unessential local manufacturing industry has been a major cause of the imposition of import restrictions. It must be assumed that there is a large permanent body of Australian secondary industry which will continue in production and will supply a significant proportion of Australia's total requirements of manufactured goods.

The strategic and commercial importance of a Commonwealth-wide dispersal of industry is something that cannot be

overlooked in any consideration of overseas trade and the growth of local manufacturing industry. In Canada, New Zealand, Australia, South Africa and other Commonwealth countries, there have been intense efforts since 1939 to diversify industry and to raise the tempo of production. It is easy to conclude that this activity brings with it such a degree of independence in the newer industrial countries that international trade must in consequence suffer a set-back. This seems to have been the reason for criticism of the industrialization of the so-called " outer sterling area". There are sufficient important examples, however, to show that a decline in trade does not necessarily follow industrial development, and that, on the contrary, such development is likely to stimulate and increase international trade.

CANADIAN EXPERIENCE

The rapid industrial expansion of Canada has been accompanied by a rise in overseas trade until Canada, with a population of some fifteen millions, now stands third among the trading nations of the world in terms of total value of overseas trade. Canadian experience illustrates the point that increasing industrialization may make a country not a smaller but a larger customer of other nations. Canadian industrial production is two-and-a-half times as large as it was before the second world war. The country is supplying an increasing proportion of her own requirements of many commodities—petroleum products and synthetic yarns and fibres are notable examples—and the list of new products not previously made in Canada is constantly lengthening. Yet imports have grown almost as much as domestic production. The value of imports in 1953 was well over five times higher than in 1939; allowing for price changes, the volume was over twice as great and processed and manufactured goods continued to fill a major rôle in the much enlarged total. During this period, although the proportion of capital goods to total imports increased, the proportion of consumer goods remained quite large and they continued to rise in volume.

In spite of the recent marked increase in domestic production, the ratio of commodity imports to the Canadian gross national product has remained high. In recent years it has varied from 17 to 19 per cent., a proportion somewhat higher than in the late 1930's—when it varied between 13 and 15 per cent.—but a little lower than in the late 1920's, when it was between 19 and 21 per cent.

It is particularly significant for industrial exporting nations that the notable expansion of Canada's manufacturing industries during the past decade has not reduced the share of imports in the total Canadian market for manufactured goods. A study made by the Department of Trade and Commerce in 1951 showed that, in 1939, imports supplied 15 per cent. of the $3,500 millions worth of manufactured goods available on the Canadian market; in 1950, when $13,800 millions worth of goods were available, imports still supplied the same proportion.

AUSTRALIAN EXPERIENCE

Canada's experience thus substantiates our assumptions. What about Australia's? On the basis of total trade and of trade per head of population, Australia ranked in 1952 as the ninth most important trading nation in the world. In spite of the growth of manufacturing capacity, imports to Australia rose from £A338 millions in 1947–48 to £A1,050 millions in 1951–52, falling back in 1953–54 to £A679 millions. The growth is even more strikingly shown by the rise in imports per head of the increasing population—from £A44 in 1947–48 to £A76 in 1953–54.

Imports and other overseas payments for goods and services, expressed as a percentage of gross national product, rose from 15 per cent. in 1938–39 to 19 per cent. in 1947–48, 23 per cent. in 1949–50 and 19 per cent. in 1953–54. It is thus clear that, in spite of the great strides in industrialization which Australia has made in recent years, the growth of national income and population have uncovered new demands and increased Australia's imports. This increase since the late 1930's has been not only in absolute terms; imports have also more than kept pace with the expanding gross national product.

It seems reasonable to assume that there will be no substantial change in the general pattern of this experience, at least in the foreseeable future. National income can be expected to continue to rise under conditions of prosperity in an expanding and developing economy. The volume of imports can be expected to grow too, even though the percentage of imports to gross national product might decline somewhat with the increasing industrialization of the country.

In short, it seems unreal, in the light of Canadian and Australian experience, to assume that the export prospects of the older manufacturing countries will be seriously limited by newer countries attaining manufacturing status and developing their home industries.

EXPORT PRODUCTION, HOME INDUSTRY AND IMPORTS

One important factor, which has been imperfectly understood in the criticism of Australia's growing manufacturing industry, is that certain of these industries can make an important contribution towards increasing Australian exports. This contribution is not necessarily in the direct form of exports of manufactured products, but through stimulating output of those agricultural goods which constitute Australia's main export items.

In recent years the pattern of farm labour has undergone great changes in many countries and Australia is no exception. Much farm labour has been transferred to the factory, the tractor has superseded the horse, and farm mechanization has made a most important contribution to the rise in rural output. By reason of its size and geographical position, Australia finds that many types of farm machinery from the smaller European countries are not well suited to local conditions. This has stimulated the relatively early development of a vigorous agricultural machinery industry that has evolved many types of machinery peculiarly suited to Australian conditions.

A striking feature of Australia's industry in the last few years is that emphasis has been placed on the manufacture of new types and a greater range of agricultural machines. While the production of these machines has helped to swell the total output of manufactured goods, their true significance is that they have made, and are continuing to make, an important contribution to increased rural output.

More recent developments in the agricultural machinery industry in Australia provide an important lesson in trends of overseas trade. Because of dollar shortage, Australia cannot buy from the dollar area those quantities of machinery demanded by the agricultural industries. One remedy is to manufacture in Australia a product better suited to Australian conditions than can easily be obtained from non-dollar suppliers. To do this, Australia needs special steels and special parts that cannot economically be provided from her own resources. These must be bought from abroad—thus increasing international trade—though not necessarily from America. The increased output of rural industry, made possible by this greater farm mechanization, provides export items to swell overseas currency earnings and thus promote a still higher level of international trade.

Imports of machinery and machine parts to Australia have risen in recent years from £A28 millions in 1947–48 to £A100

millions in 1953–54. In spite of the growth of local manufacturing industry, Australia is still Britain's best customer. It is unreal to expect that Australia can continue to import from Britain at the levels reached in abnormal years such as 1951–52 or 1954–55. Rather should these be regarded as unusual periods of over-stimulated import trade, based on temporarily inflated export earnings, which cannot be expected to continue and Australia's major overseas suppliers should surely make their plans accordingly.

Australia is a young country with a long period of rapid capital development ahead of it. To some extent the capital goods that will be required can be produced locally; but Australia cannot, with her comparatively small population, expect to produce all the types of goods and qualities of material needed over the whole field of economic development. Even those industrial organizations which are large by local standards must for many years to come limit the number of lines they produce if they are to remain efficient in what must always be a relatively small market compared with some other countries of the world. Australia can thus be expected to continue to import a significant proportion of manufactured requirements, even though her own industries appear to be growing all the time.

There may be a change in emphasis from one class of goods to another but Canadian experience strongly points to the probability that expansion of consumer spending, along with rapid population growth and the higher level of employment arising from local factory expansion, could very well outstrip the speed with which new production from local factories could reach the market. A further example of the importance of this growth of local demand is the United States of America, where population had exceeded 100 millions before the country began to show definite signs that it no longer needed to depend on manufactured imports.

Recent trends in no way indicate that Australia's industrial development will cause any loss of British markets, taking the long-term view.

CREDIT RESTRICTION

It is at this point that the second set of important criticisms of recent Australian policy, namely failure to impose adequate credit restraint, assumes significance. What is the full explanation of the apparently chronic tendency for Australia to import more than can be paid for from current export proceeds? This

heavy demand for imports is closely associated with rapid development under conditions of full employment combined with a heavy flow of immigrants. There is no paradox in an economic climate of rapid industrial expansion, high income from exports, rising living standards and increasing demand for imports. These things go hand in hand.

Capacity to import depends on capacity to consume and capacity to pay. Capacity to consume is related to the standard of living and is increased by population growth; capacity to pay is, of course, related to the volume of exports and the prices which exports command in overseas markets. Australia is a country with a high standard of living and therefore with a tendency to import at a relatively high level. This tendency has been stimulated by the rapid growth of population since 1945. Between 1945 and 1955 Australia's population rose by 20 per cent.—from 7½ millions to 9 millions. It has been estimated, on the basis of immigration at the rate of 100,000 people a year and assuming the continuation of present net reproduction rates, that the population will exceed 12 millions by 1970. It is perhaps not generally realized that the rate of increase in Australia's population in recent years compares favourably with that of the American population in some of the periods of its most rapid growth. This growth of population obviously means a constantly expanding market which in turn is likely to continue to demand a rising volume of imports. It is to be expected that this demand should progress somewhat jerkily, and not in a steady, even flow from year to year.

Pressure on resources is part and parcel of rapid economic development. Australia's internal resources have been subjected to constant pressure throughout the war and post-war years. Under conditions of full employment and heavy capital investment, it seems to be inevitable that some of the pressure should cause a spilling over of demand into the import field. This, undoubtedly, is part of the explanation of the heavy volume of imports, particularly of consumer goods.

It is perhaps logical to reach the conclusion that, in these circumstances, appropriate action would be the imposition of more severe credit restriction and determined measures of fiscal control. There is undoubtedly some room for such controls and, moreover, they have been applied. In 1952 there was credit restriction and a disinflationary budget which caused a check to business expansion and a sharp rise in unemployment. More recently, it might be argued that there is little evidence of credit restriction since the advances of the banking system have risen from £A778 millions to £A890

millions between June, 1954, and April, 1955. Advances, however, had contracted sharply from £A761 millions in July, 1952, to £A662 millions in the year to June, 1953. Thus the present rise represents, to some extent, a recovery from an earlier decline and may well have been necessitated by continued rapid economic growth in the meantime. It may still be argued that this recent expansion of credit has been more rapid than is desirable. It has been accompanied, however, by a measure of fiscal restraint through a succession of budget surpluses, and the transfer to trust funds of substantial unspent balances, which have thus been removed from the credit system.

In an economy developing rapidly and absorbing an annual intake of a high proportion of immigrants, it would be relatively easy to apply credit and fiscal control measures which could prove to be too drastic. There is an ever-present danger that the damping down of activity to check inflationary forces could halt expansion and seriously damage the even course of development. The selected weapon of control in the form of import cuts must be critically surveyed against this background. Import restriction in many respects is not a satisfactory method of control, because it can fail to take due cognizance of the degree of efficiency of local industry, and through limiting the competition of imported goods can perpetuate inefficient industry. It could thus seriously upset the cost structure by permitting some industries to continue in production which, under conditions of import competition, would not be able to survive. Moreover, import restrictions tend to become self-perpetuating by the very fact that they stimulate advance buying by importers in anticipation of the next cut. It can be strongly argued that, for these reasons, over-all credit restriction to damp down local demand would be a more satisfactory control measure, avoiding undue protection of local industry and subjecting the whole field of industry to the beneficial discipline of import competition. It would also check excessive growth of hire purchase facilities.

Such measures are comfortable in theory but may not work out satisfactorily in the practical conditions of a rapidly developing Australia in the middle of the twentieth century. There is much to be said for a system that will avoid the risks of undue restriction and the possibly severe consequences for local industry of serious competition from abroad. As was seen recently in Australia, credit contraction can cause severe fluctuations in the level of business activity and a sharp increase in unemployment. More recent evidence from Japan confirms

this experience. Deflationary measures introduced in that country between October, 1953, and April, 1954, reduced the deficit on visible trade from the equivalent of $US998 millions per annum to $US165 millions. But this improvement in the overseas balance was accompanied by internal dislocation caused by the deflationary measures adopted. Business failures increased and certain industries suffered; probably the worst case was coal mining, the number of active collieries declining from 812 to 671, while employment fell by 10 per cent. There was also an increase in unemployment in manufacturing industry, the total rising from 390,000 to a peak of 710,000. The index of production for mining and manufacturing industries fell in the second and third quarters of 1954 by over 10 per cent.

Such fluctuations, if accompanied by continued heavy pressure in some directions from severe import competition, could cause a serious decline in activity, with the risk for a young expanding economy that the rate of development would be seriously slowed down over a period and capacity to absorb immigrants severely checked.

On the other hand, import restrictions need not be applied blindly. It is possible for them to form part of a careful plan designed to check those imports which can justly be regarded as less essential, either because they are produced locally without drawing unduly on important resources, or because, by any reasonable standards of judgement, they are in the luxury category. By careful co-ordination of import restriction with tariff policy, supported by the considered judgements of such bodies as Tariff Boards, it should be possible to work out a satisfactory system of import control which would avoid the most unfortunate consequences of either excessive credit restriction or blanket import cuts.

Unfortunately, it cannot be argued that Australia has adopted the most efficient form of import control, although the machinery is in existence for an effective system of import restriction to be evolved and the system which is in force has been by no means blindly applied. One of the most significant differences between the restrictions imposed in October, 1954, and very greatly strengthened in April, 1955, on the one hand, and the earlier cuts in 1952, on the other hand, is that the current controls have been applied in good time, and not rushed through urgently, as appeared to be the case in the previous period. The consequent disturbances to overseas exporters and local importers and manufacturers have been correspondingly reduced.

LEVEL OF IMPORTS IN THE LONG TERM

Analysis of the different types of Australian imports shows that, in addition to a large quantity of consumer goods, there has been a most important inflow of investment goods for development works and for the equipment of industry. As long as development continues there is likely to be demand for investment goods. It is interesting in this connection to record that the level of savings per head of population and the proportion of national income going into investment in Australia at present are probably exceeded among the free countries of the world only by Canada and Norway.

It is unlikely that Australia can indefinitely maintain, entirely out of her own resources, the necessarily heavy burden of capital formation to finance a rapid development programme. Some degree of borrowing overseas seems to be desirable and indeed necessary, if Australia is to maintain the recent rate of progress. The extent to which such borrowing is possible will materially influence the continuing level of imports. Discussion of Australia's capacity to import has, so far in this article, been confined solely to the financing of such imports out of current exports. It would appear that the necessary capital to enable Australia to continue to finance a rapid rate of national expansion must be obtained, partly at least, by overseas borrowing.

Australia has recently borrowed from the International Bank for Reconstruction and Development (she is now the largest single borrower from that institution), from the International Monetary Fund and from overseas capital markets. Although the amounts have not been large in terms of present-day requirements, they have provided a source of borrowing to finance imports of capital equipment for national development works and services. Much of the new capital which has become available in recent years has been furnished by private enterprise investing in industries in Australia. This capital has been provided mainly from the United Kingdom, but with important contributions also from the U.S.A.

Existing foreign exchange regulations, however, do little to encourage investment from overseas, because they give no undertaking to the overseas investor that capital can be repatriated if and when desired. It should be possible to devise some means of permitting legitimate repatriation of capital funds transferred to Australia for investment in industry, but which had failed to meet expectations and which the principals concerned therefore desire to withdraw. Transactions

of this type should be capable of differentiation from those involving the withdrawal of "hot money" which had moved to Australia solely for speculative purposes. If such assurances could be given they could not fail to be an important factor in the attraction of funds for long-term capital investment, particularly from the dollar area.

LONG-TERM OUTLOOK FOR EXPORTS

In spite of the rapid growth of manufacturing industry, Australia is still mainly an exporter of pastoral, agricultural and mining products. With the rise in commodity prices in the post-war period, there has been a big increase in the total value of exports from Australia. Long-term prospects for the maintenance and improvement of Australia's export income are closely wrapped up with the future of world commodity prices, but the volume of production of the main export items is also of paramount importance. The level of output is particularly important if sufficient surplus is to remain, over and above the requirements of the rapidly growing population, to enable export income to keep pace with the rising demand for imports.

Perhaps the most encouraging feature in the Australian economy at the present time is the emphasis on rural production that is reappearing so strongly. This emphasis stems from the recent important strides that have been made in the application of science to agriculture. Over the years, Australian scientists have made outstanding contributions to the solution of many difficulties affecting local rural industry, with its peculiar problems of soil and climate. There have recently been some further most important advances. Some of the most significant have been in the development of leguminous plants, capable of surviving the wide variations of climate and of imparting nitrogen to soils hitherto lacking in fertility because of the absence of the necessary nitrogen supplies. These developments have made it possible to raise the fertility of the soil over vast areas in the good to higher rainfall districts. This not only has meant improvement of pastures but has also made possible more intensive land use for agriculture as distinct from grazing.

The most dramatic development of this type has been the relatively recent discovery that large tracts of country have been deficient in small quantities of various minerals known as "trace elements." The lack of these has rendered otherwise highly suitable country relatively unproductive. The solution of this problem has opened up possibilities of raising the productivity of areas which must be regarded as vast by any

standards of measurement, again with the strong prospect of increasing output many-fold in the districts concerned.

The application of science to mineral discovery and mining has also opened up new deposits of important minerals, including uranium. In addition, there have been large increases in production of many base metals which have been mined in considerable quantities in Australia over a long period.

SIGNIFICANCE OF WOOL

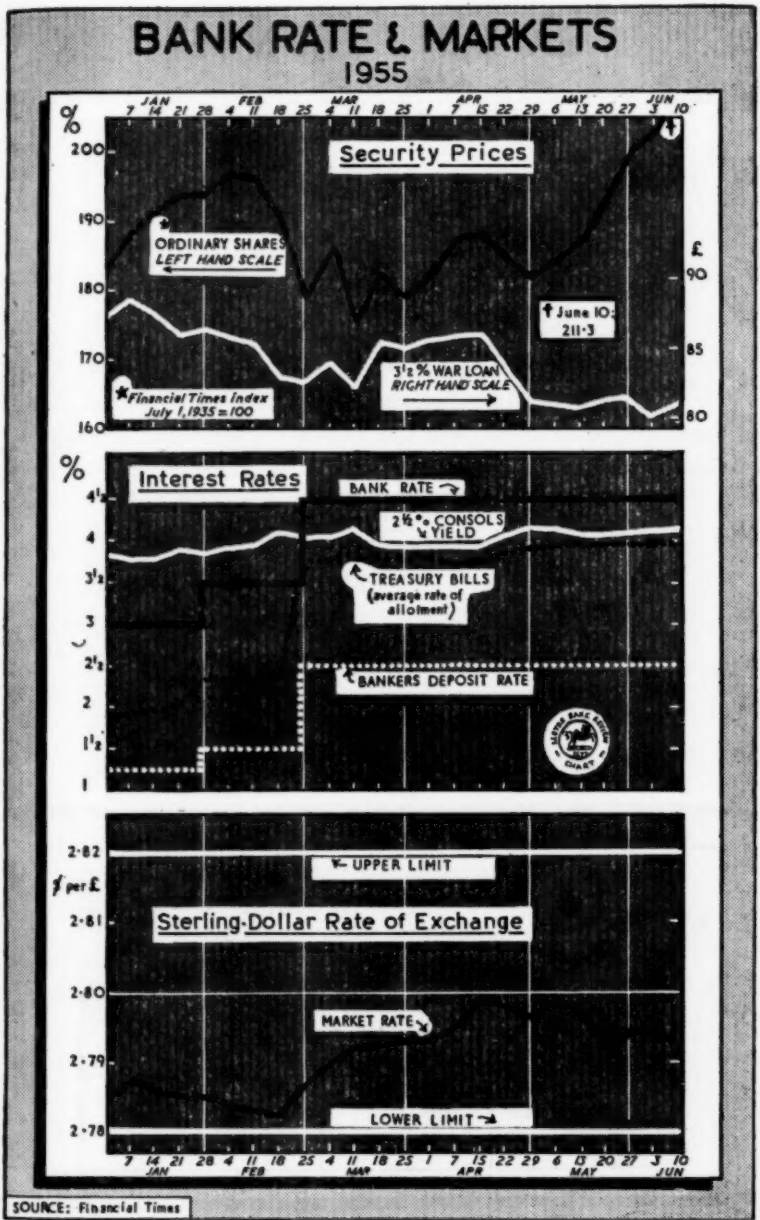
The main item among Australia's exports has been and, in spite of industrial development, continues to be, wool. In recent years wool has increased in importance to furnish 50 per cent. or more of Australia's export income. Wool is important, however, to the sterling area as a whole, because it earns income in many currencies available to finance import items, not to Australia alone but also to other countries in the sterling area. Although not a very consistent dollar earner, on account of the wide fluctuations in American wool purchases from season to season, it has, over a period of years, earned large supplies of dollars. Australian wool is also a consistent earner of Continental currencies, thus making an important contribution to United Kingdom resources in transactions with the European Payments Union. Australia's production of wool has been steadily expanding, both through the rise in sheep numbers and through the constant improvement in the average weight of wool per sheep. It is significant for the sterling area that many of the important recent scientific discoveries are likely to exert their major influence by raising the size of the Australian wool clip.

CONCLUSION

These developments hold out high hopes for the long-term expansion of output of those products upon which Australia depends, and seems likely to continue to depend, for vital export income. Providing there is no drastic decline in the prices of major pastoral and agricultural commodities, the maintenance of a satisfactory level of export receipts from Australia's steadily expanding rural production seems, in the light of these recent scientific developments, reasonably assured. Taking the long-term view, there thus seems little need to fear a continuance of chronic balance of payments difficulties for the sterling area on account of Australia's overseas trade.

D. H. MERRY.

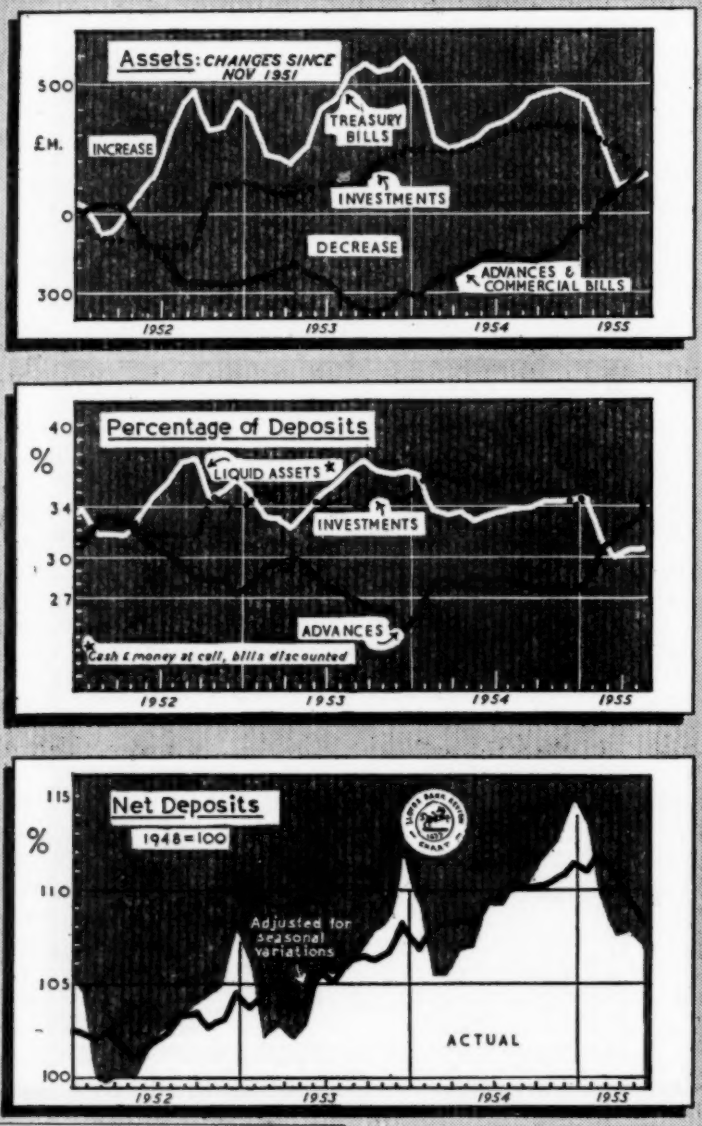
Melbourne.
May, 1955.



SOURCE: Financial Times

The increase in Bank Rate to 4½ per cent. in February was followed by a marked improvement in sterling against the dollar but a large part of this recovery has been lost in recent weeks. The *Financial Times* index of industrial ordinary shares has been breaking fresh ground, reaching a new peak of 219·8 on June 22nd.

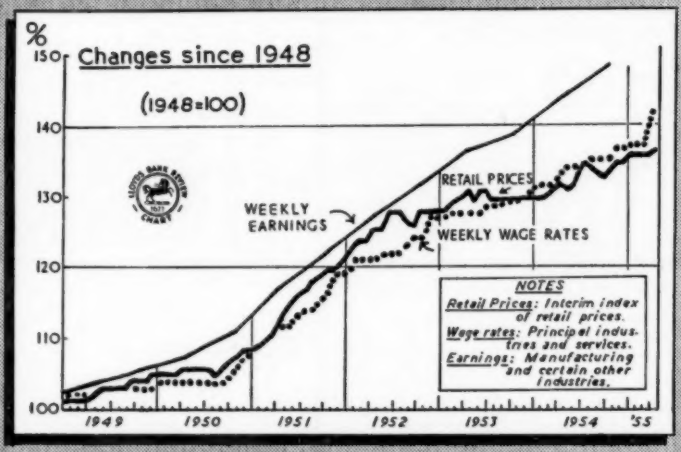
BANKING TRENDS
CLEARING BANKS



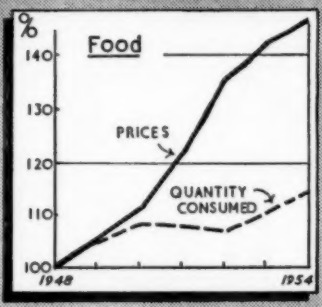
SOURCE: Committee of London Clearing Bankers

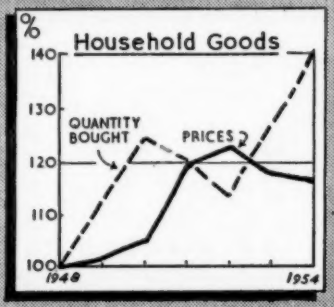
After rising steadily since the middle of 1952 Lloyds Bank's index of deposits declined by nearly four points between February and May. Clearing bank investments have been reduced by more than £200 millions since the beginning of the year.

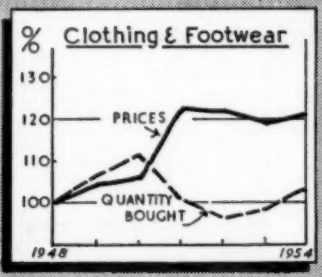
PRICES & WAGES

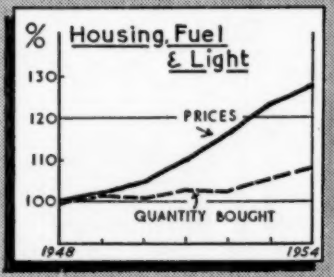


CHANGES IN MAIN GROUPS



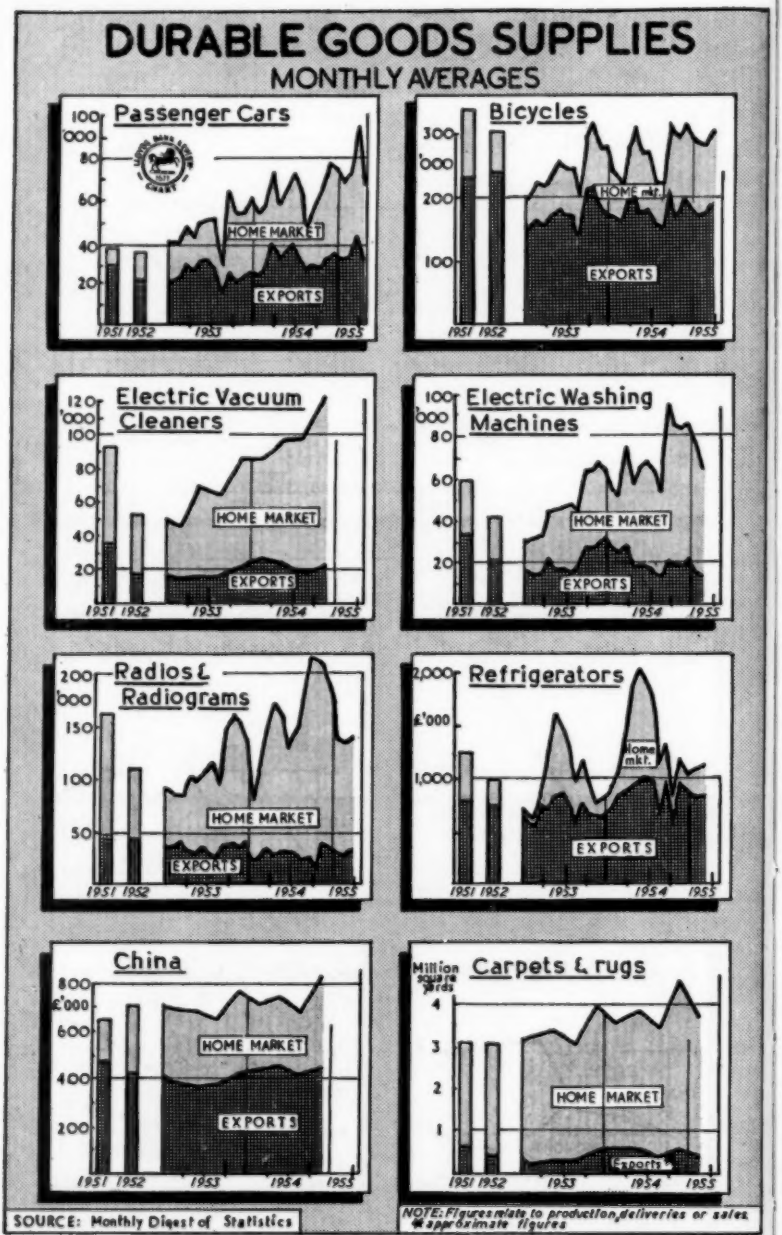




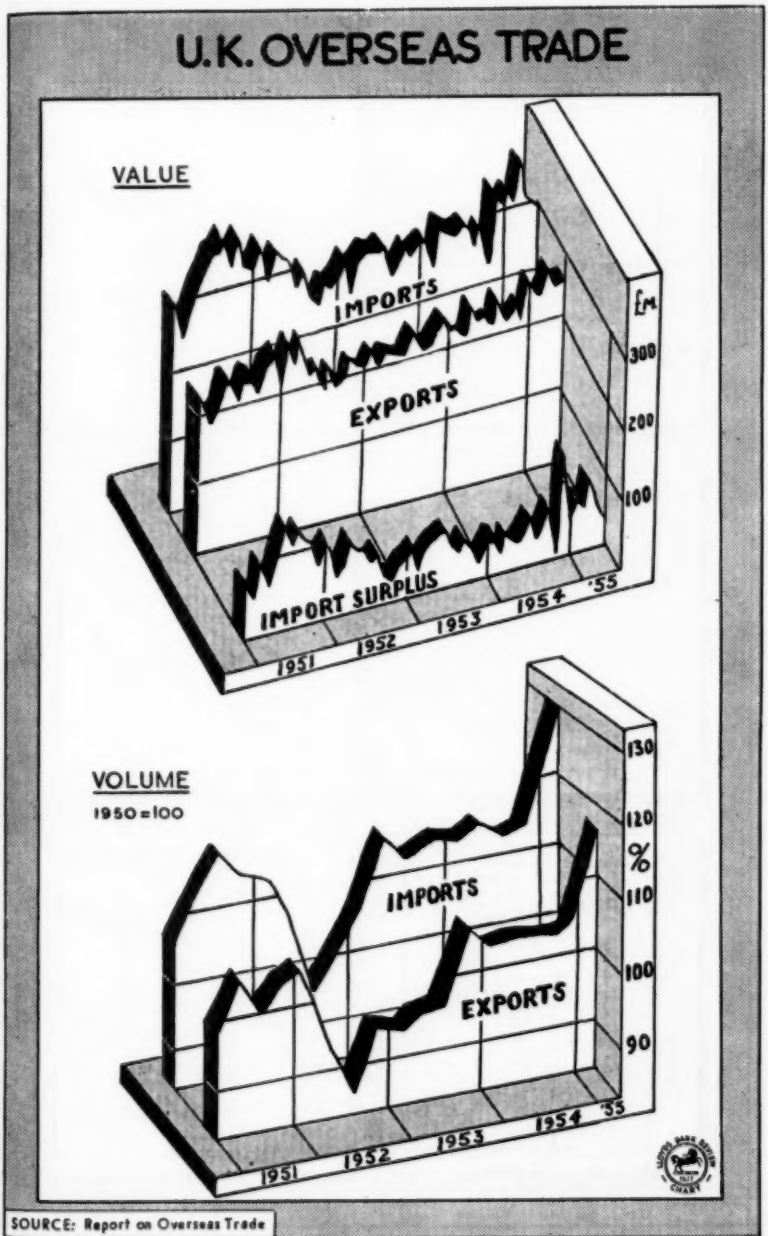


SOURCE: Monthly Digest of Statistics

Taking 1948 as the base-year, retail prices in general have risen by about a third, wage-rates have increased by somewhat more while earnings (in October, 1954) were up by nearly 50 per cent. Of the above groups of commodities food prices have risen most since 1948, while as regards increase in quantity bought household goods head the list.



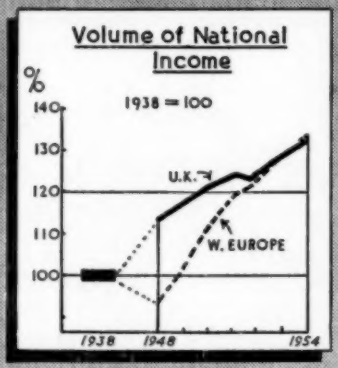
Increased supplies of durable goods have been coming on to the home market: in 1954, compared with 1953, supplies of electric washing machines increased by 75 per cent., radios and radiograms by 65 per cent., vacuum cleaners by 60 per cent. and passenger cars by 30 per cent.

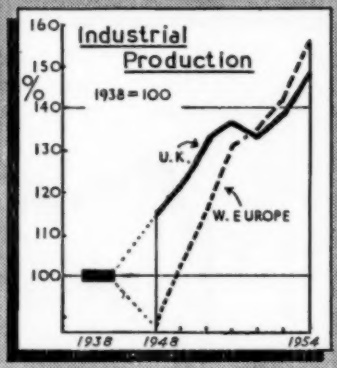


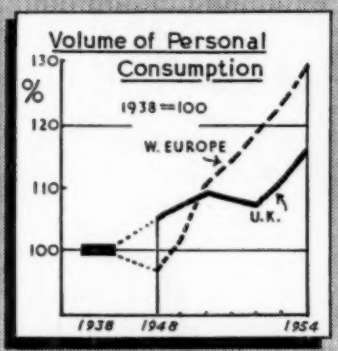
SOURCE: Report on Overseas Trade

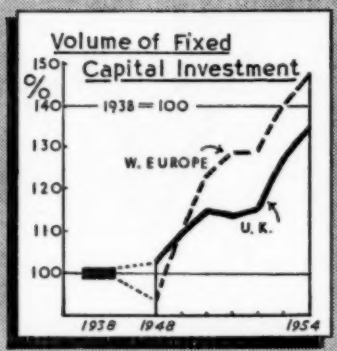
In terms of volume, imports in the first quarter were 14 per cent. above the 1954 level, compared with an increase of 12 per cent. in exports. Since March, however, the rising trend of imports appears to have been checked, resulting in a marked reduction in the import surplus.

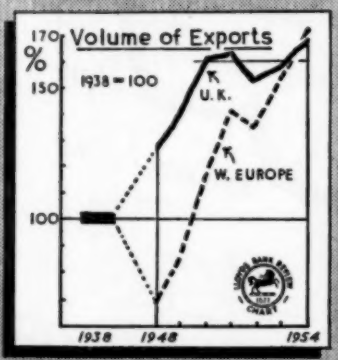
U.K. & WESTERN EUROPE

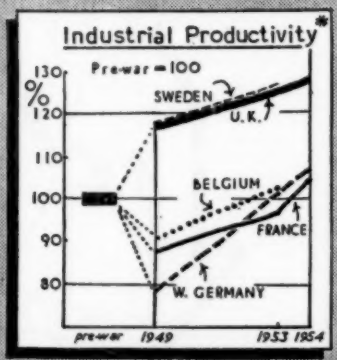










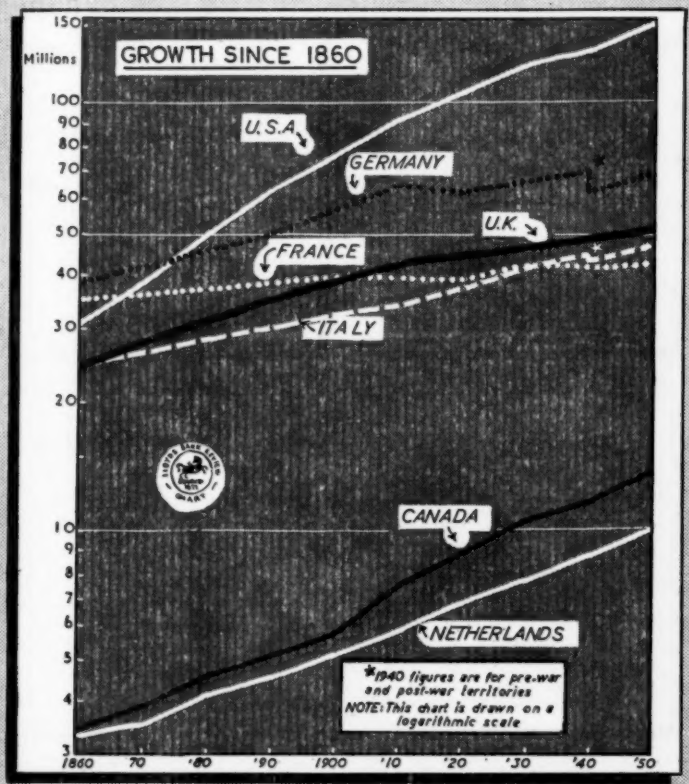


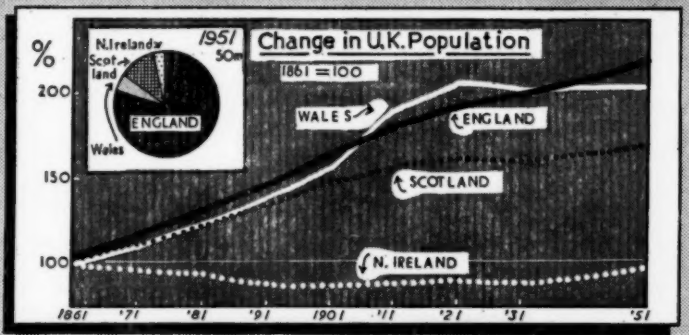
SOURCES: O.E.E.C. 6th Report
O.E.E.C. Statistical Bulletin

* output per employee-hour

Recent years have seen a striking economic expansion in Western Europe and in some respects (e.g. the volume of personal consumption or of fixed capital investment) the increase since pre-war is now appreciably greater than for the U.K. Industrial productivity in this country, however, appears to have risen considerably more than in a number of European countries.

POPULATION

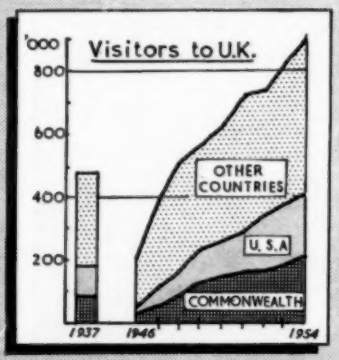


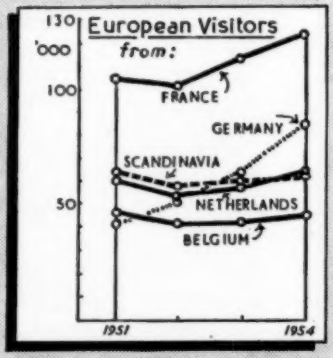


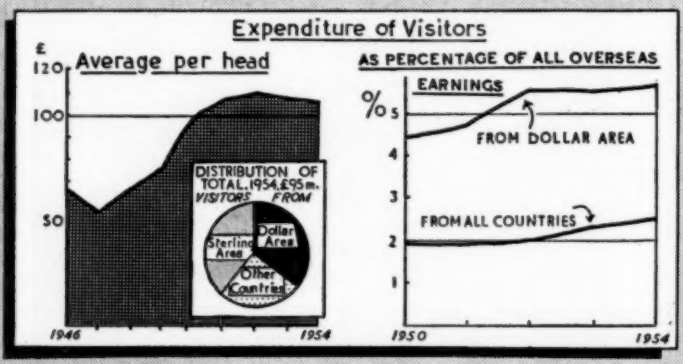
SOURCES: U.N. Population Year Book
Annual Abstract of Statistics

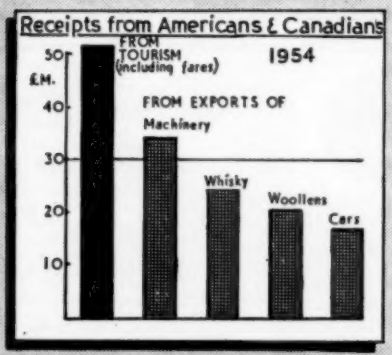
The population of the U.K. has more than doubled since 1861, England experiencing the greatest relative increase. In Europe, Germany's population has almost doubled while France, in contrast, has seen a growth of less than 20 per cent. In America, the increase has been about fivefold over the period.

TOURISM









SOURCES: Board of Trade Journal
British Travel & Holidays Association

Visitors to Britain continue to grow in number—last year there were 85 per cent. more than in the peak pre-war year of 1937—and their expenditure represents a useful addition to our foreign exchange earnings. Receipts from American and Canadian tourists in 1954 exceeded our proceeds from any individual merchandise export to North America.